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American Institute of Certified Public Accountants. Single Audit Working Group

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A U D I T G U I D E

Government Auditing Standards and Circular A-133 Audits

MAY 1, 2010



Audit Guide: Government Auditing Standards and Circular A-133 Audits
May 1, 2010



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A U D I T G U I D E

Government Auditing Standards and Circular A-133 Audits

WITH CONFORMING CHANGES AS OF
MAY 1, 2010

Includes guidance on the July 2007 revision to *Government Auditing Standards* and the Single Audit Act Amendments of 1996 and the June 26, 2007, revision to Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*

This AICPA Audit Guide, *Government Auditing Standards and Circular A-133 Audits*, was originally issued as Statement of Position 98-3, *Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards*, in March 1998. This edition has been modified by the AICPA staff to include certain changes necessary because of the issuance of authoritative pronouncements since the guidance was originally issued. The schedule of changes identifies all changes made in this edition of the guide. The changes do not include all those that might be considered necessary if the guide were subjected to a comprehensive review and revision.

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Preface

About AICPA Audit Guides

This Audit Guide (guide) presents guidance for the audits of financial statements conducted in accordance with *Government Auditing Standards* (also referred to as the Yellow Book), issued by the Comptroller General of the United States of the U.S. Government Accountability Office (GAO). It also presents the recommendations of the AICPA Single Audit Working Group for the conduct of audits in accordance with the Single Audit Act Amendments of 1996 and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133). Auditing guidance included in an AICPA Audit Guide is recognized as an interpretive publication pursuant to AU section 150, *Generally Accepted Auditing Standards* (AICPA, *Professional Standards*, vol. 1). Interpretive publications are recommendations on the application of Statements on Auditing Standards (SASs) in specific circumstances, including engagements for entities in specialized industries. An interpretive publication is issued under the authority of the Auditing Standards Board (ASB) after all ASB members have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with the SASs. The members of the ASB have found this guide to be consistent with existing SASs.

The auditor should be aware of and consider interpretive publications applicable to his or her audit. If an auditor does not apply the auditing guidance included in an applicable interpretive publication, the auditor should be prepared to explain how he or she complied with the SAS provisions addressed by such auditing guidance.

This AICPA Audit Guide, which also contains attestation guidance, is recognized as an interpretive publication pursuant to AT section 50, *SSAE Hierarchy* (AICPA, *Professional Standards*, vol. 1). Interpretive publications include recommendations on the application of Statements on Standards for Attestation Engagements (SSAEs) in specific circumstances, including engagements for entities in specialized industries. Interpretive publications are issued under the authority of the ASB. The members of the ASB have found this guide to be consistent with existing SSAEs.

A practitioner should be aware of and consider interpretive publications applicable to his or her attestation engagement. If the practitioner does not apply the guidance included in an applicable AICPA Audit and Accounting Guide, the practitioner should be prepared to explain how he or she complied with the SSAE provisions addressed by such guidance.

Recognition

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Auditing Standards Board

AICPA Single Audit Working Group (1996–1998)

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The AICPA gratefully acknowledges the contribution of time and effort by those who participated in the AICPA task force established to revise the illustrative auditor reports required under Circular A-133 for the requirements of SAS No. 115, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 325), as follows: Frank Crawford, Ralph DeAcetis, Kristine G. Devine, John Fisher, Eric Formberg, Amanda Nelson, George Rippey, and Randy Roberts.

In addition, the AICPA gratefully acknowledges those who reviewed drafts of the conforming changes to this guide: Marcia Buchanan, Barbara Cevallos, Ralph DeAcetis, Kristine Devine, Eric Formberg, Jeanette Franzel, John Good, Karen Kassar, Heather Keister, Karen Kerber, Paul Kinney, Harold Monk, Jr., Amanda Nelson, Terry Ramsey, George Rippey, Randy Roberts, and Gil Tran. In addition, the AICPA would like to acknowledge the contributions made by Venita M. Wood to previous editions of this guide.

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Guidance Considered in This Edition

This edition of the guide has been modified by the AICPA staff to include certain changes necessary due to the issuance of authoritative guidance since the guide was originally issued. Authoritative guidance issued through May 1, 2010, has been considered in the development of this edition of the guide. This includes relevant guidance issued up to and including the following:

- SAS No. 120, *Required Supplementary Information* (AICPA, *Professional Standards*, vol. 1, AU sec. 558)
- Interpretation No. 19, "Financial Statements Prepared in Conformity With International Financial Reporting Standards as Issued by the International Accounting Standards Board," of AU section 508, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 9508 par. .93–.97)

- Interpretations issued (or reissued) through May 1, 2010, including Interpretation Nos. 1–4 of AU section 325, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 9325 par. .01–.13)
- The Single Audit Act Amendments of 1996
- OMB Circular A-133, as revised on June 26, 2007
- *Government Auditing Standards*, July 2007 Revision

Users of this guide should consider guidance issued subsequent to those listed previously to determine their effect on entities covered by this guide. In determining the applicability of recently issued guidance, its effective date should also be considered.

The changes made to this edition of the guide are identified in the schedule of changes in appendix C. The changes do not include all those that might be considered necessary if the guide were subjected to a comprehensive review and revision.

References to Professional Standards

In citing the professional standards, references are made to AICPA *Professional Standards*. When referencing professional standards, this guide cites section numbers and not the original statement number, as appropriate. For example, SAS No. 54 is referred to as AU section 317, *Illegal Acts by Clients* (AICPA, *Professional Standards*, vol. 1).

Select Recent Developments Significant to This Guide

Withdrawal of GAAP Hierarchies From the Auditing Standards

In response to the issuance of recent pronouncements by FASB, the Governmental Accounting Standards Board, and the Federal Accounting Standards Advisory Board to incorporate their respective GAAP hierarchies into their respective authoritative literature, the ASB has withdrawn SAS No. 69, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*, from the auditing literature effective September 2009. Similarly, with the release of Public Company Accounting Oversight Board (PCAOB) Auditing Standard No. 6, *Evaluating Consistency of Financial Statements* (AICPA, *PCAOB Standards and Related Rules*, Auditing Standards), and conforming amendments in January 2008, the PCAOB also removed the GAAP hierarchy from its interim auditing standards applicable to issuers.

ASB's Clarity Project

In an effort to make generally accepted auditing standards (GAAS) easier to read, understand, and apply, the ASB launched the Clarity Project. When completed, the majority of the clarified auditing standards will be issued as one SAS that will supersede all prior SASs.* The new audit standards are expected to

* Standards that address current issues have their own separate effective date. One standard issued in the clarity format that has an earlier effective date is Statement on Auditing Standards (SAS) No. 117, *Compliance Audits* (AICPA, *Professional Standards*, vol. 1, AU sec. 801). Footnote †, which follows, contains additional information on SAS No. 117.

apply to audits of financial statements for periods ending on or after December 15, 2012.

The foundation of the ASB's Clarity Project is the establishment of an objective for each auditing standard. These objectives will better reflect a principles-based approach to standard-setting. In addition to having objectives, the clarified standards will reflect new drafting conventions that include

- adding a definitions section, if relevant, in each standard.
- separating requirements from application and other explanatory material.
- numbering application and other explanatory material paragraphs using an A prefix and presenting them in a separate section (following the requirements section).
- using formatting techniques, such as bulleted lists, to enhance readability.
- adding special considerations relevant to audits of smaller, less complex entities.
- adding special considerations relevant to audits of governmental entities.

The project also has an international convergence component. The ASB expects that, upon completion of the project, nearly all the requirements of International Standards on Auditing (ISAs) will also be requirements of U.S. GAAS. AICPA Audit and Accounting Guides, as well as other AICPA publications, will be conformed to reflect the new standards resulting from the Clarity Project after issuance and as appropriate based on the effective dates.

Purpose and Applicability

This Audit Guide provides guidance (chapters 1–4) on the auditor's responsibilities when conducting an audit of financial statements in accordance with *Government Auditing Standards* (also referred to as the Yellow Book). This guide has been prepared using the *Government Audit Standards*, July 2007 Revision.

It also provides guidance (chapters 1 and 5–14) on the auditor's responsibilities when conducting a single audit or program-specific audit in accordance with the Single Audit Act Amendments of 1996 and Circular A-133. This guide was originally issued as Statement of Position (SOP) 98-3, *Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards*, in March 1998 and updated annually for conforming changes for relevant guidance contained in authoritative auditing standards and other requirements. The AICPA converted SOP 98-3 into an Audit Guide in 2003. That conversion did not supersede the guidance that appeared in SOP 98-3 but only changed its format.

Concerning an audit of financial statements in accordance with *Government Auditing Standards*, this guide

- describes the applicability of *Government Auditing Standards*.
- discusses the relationship between generally accepted auditing standards and *Government Auditing Standards*.

- discusses the general standards and additional fieldwork and reporting standards of *Government Auditing Standards*.
- describes the auditor's responsibility for considering internal control over financial reporting, compliance with applicable laws, regulations, and provisions of contracts and grants agreements, fraud, and abuse.
- describes the auditor's responsibility for reporting and other communications and provides examples of the required auditor's reports.

Concerning an audit of federal awards in accordance with Circular A-133,¹ this guide

- describes the applicability of and provides an overview of the requirements of the Single Audit Act Amendments of 1996 and Circular A-133.
- discusses the relationship between *Government Auditing Standards* and Circular A-133.
- describes the auditor's additional responsibilities for considering internal control over compliance with applicable laws, regulations, and program compliance requirements; performing tests of compliance with those requirements; and performing procedures on the schedule of expenditures of federal awards.
- discusses considerations in designing an audit approach that includes audit sampling to achieve both compliance and internal control over compliance related audit objectives in a Circular A-133 compliance audit.
- describes the auditor's responsibilities in a program-specific audit.
- describes the auditor's responsibility for reporting and provides examples of the required auditor's reports.

Further, this guide incorporates guidance from the following documents:

- SAS No. 117, *Compliance Audits* (AICPA, *Professional Standards*, vol. 1, AU sec. 801)[†]
- *Government Auditing Standards*, July 2007 Revision
- The Single Audit Act Amendments of 1996 and Circular A-133 (as revised on June 26, 2007) and the *OMB Circular A-133 Compliance Supplement* (Compliance Supplement)

Impact of the American Recovery and Reinvestment Act of 2009 on Single Audits

The American Recovery and Reinvestment Act of 2009 (Recovery Act) was enacted in February 2009 and was designed to stimulate the U.S. economy. The

¹ In this guide, the use of the terms *single audit* or *audit in accordance with Circular A-133* includes both the financial statement audit and the compliance audit that is performed under Circular A-133. The use of the term *Circular A-133 compliance audit* includes only the compliance audit that is performed under Circular A-133.

[†] The guidance in SAS No. 117 is effective for compliance audits for fiscal periods ending on or after June 15, 2010. The guidance in SAS No. 117 has been incorporated into this edition of the guide.

total cost of the spending in the Recovery Act is \$787 billion dollars, a significant portion of which will become subject to single audit requirements. To facilitate communication regarding the Recovery Act, the federal government developed the website www.recovery.gov to facilitate a transparent process to ensure accountability for the execution of the package.

The Recovery Act will have a significant impact on single audits of those entities receiving Recovery Act funding. Such funding is intended to supplement existing federal programs, create new programs or provide more broad fiscal relief. The accountability and transparency provisions of the Recovery Act impose significant additional requirements for those receiving funding. The OMB is charged with the responsibility of developing government-wide guidance for carrying out programs and activities enacted in the Recovery Act. Because the guidance is being issued on an ongoing basis, it is important for auditors to keep up to date on the issues, requirements, and guidance related to Recovery Act funding. Some of this information has been incorporated into the *Compliance Supplement* and subsequently issued addendums to the *Compliance Supplement*. This information is available on the OMB website at www.whitehouse.gov/omb/grants_circulars/. Other OMB guidance on Recovery Act provisions can be found at www.whitehouse.gov/omb/recovery_default.

Also, the AICPA Governmental Audit Quality Center (GAQC) has launched the "Recovery Act Resource Center" (www.aicpa.org/INTERESTAREAS/GOVERNMENTALAUDITQUALITY/RESOURCES/RECOVERYACTRESOURCECENTER/Pages/default.aspx) that is open to the public and provides access to all GAQC Recovery Act communications, archived versions of member conference calls discussing Recovery Act matters, tools and resources, and links to other websites of interest to auditors.

Detailed Recovery Act guidance has not been incorporated into this edition of the guide. However, a section has been added at the end of each chapter in part II of this guide (chapters 5–14) titled "American Recovery and Reinvestment Act Considerations" to highlight areas of consideration related to Recovery Act awards in a compliance audit.

Effect of Public Company Accounting Oversight Board Standards on Entities Subject to *Government Auditing Standards*

The PCAOB establishes standards for audits of *issuers*, as that term is defined by the Sarbanes-Oxley Act of 2002 or whose audit is prescribed by the rules of the Securities and Exchange Commission. Other entities are referred to as *nonissuers*. Although many entities that are subject to *Government Auditing Standards* are nonissuers, some are issuers. Such issuers may include, for example, lending institutions that participate in federally sponsored loan programs such as housing and education. In December 2007, the GAO issued guidance titled "Guidance on Complying with *Government Auditing Standards* Reporting Requirements for the Report on Internal Control for Audits of Certain Entities Subject to the Requirements of the Sarbanes-Oxley Act of 2002 and *Government Auditing Standards*" that recognizes that the use of PCAOB's framework for assessing control deficiencies could result in inconsistencies in reporting internal control deficiencies under the Yellow Book. The GAO guidance facilitates the reporting of internal control deficiencies identified during audits conducted under both PCAOB and Yellow Book standards to ensure

the consistency of information included in the Yellow Book report on internal control and to assist auditors in complying with Yellow Book standards. It is available on the Yellow Book website at www.gao.gov/govaud/ybk01.htm.

Effective Date

The provisions of this guide are applicable to audits of fiscal years beginning after June 30, 1996, in which the related fieldwork commences on or after March 1, 1998. The provisions of this guide, including conforming changes, that arise from AICPA auditing standards, *Government Auditing Standards*, the Single Audit Act Amendments of 1996, and Circular A-133 are effective as of the effective date of those standards and requirements. This guide does not change the effective dates of those standards and requirements. The auditing conforming changes made in this edition of this guide are effective for audits of financial statements for which sufficient appropriate audit evidence to support the opinion is obtained after its issuance, subject to the effective dates of the underlying authoritative pronouncements.

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Chapter 1

Introduction

Purpose and Applicability

1.01 This Audit Guide (guide)¹ has a two-fold purpose:

- a. The first purpose is to provide auditors with a basic understanding of the procedures they should perform and of the reports they should issue for audits of financial statements conducted in accordance with *Government Auditing Standards* (also referred to as the Yellow Book), issued by the Comptroller General of the United States of the U.S. Government Accountability Office (GAO).² *Government Auditing Standards* incorporates the fieldwork and reporting standards of generally accepted auditing standards (GAAS) and the related Statements on Auditing Standards (SASs) issued by the AICPA unless the Comptroller General of the United States excludes them by formal announcement.³
- b. The second purpose is to provide auditors of states, local governments, and not-for-profit entities (NFPs) that receive federal awards with a basic understanding of the procedures they should perform and of the reports they should issue for single audits and program-specific audits conducted in accordance with the Single Audit Act Amendments of 1996,⁴ Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133),⁵ and the related *OMB Circular A-133 Compliance Supplement (Compliance Supplement)*,⁶ which incorporate the procedures and reports required by *Government Auditing Standards*.

1.02 *Government Auditing Standards* contains requirements and guidance for financial audits, attestation engagements, and performance audits. This guide addresses the *Government Auditing Standards* requirements and

¹ Reference to paragraphs are to those in the guide unless otherwise specified.

² The standards and guidance applicable to financial audits, including audits of financial statements, are contained in chapters 1–5 of *Government Auditing Standards* and include ethical principles and general, fieldwork, and reporting standards. An electronic version of *Government Auditing Standards* is on the Yellow Book page of the Government Accountability Office (GAO)'s website at www.gao.gov/govaud/ybk01.htm. The Yellow Book page of the GAO website also provides instructions for obtaining a printed copy of the standards.

³ To date, the Comptroller General has not excluded any fieldwork or reporting standards or related Statements on Auditing Standards.

⁴ The Single Audit Act Amendments of 1996 (Public Law 104-156) was enacted into law in July 1996 and replaced the Single Audit Act of 1984. Appendix A of this guide is a reprint of the Single Audit Act Amendments of 1996.

⁵ Appendix B of this guide reprints Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, as revised on June 26, 2007. The circular can be obtained from the OMB's website at www.whitehouse.gov/omb/grants_circulars/.

⁶ The *OMB Circular A-133 Compliance Supplement (Compliance Supplement)* is updated periodically, but at least annually. It is available from the Government Printing Office by calling 202–512-1800. In addition, the *Compliance Supplement* (including any issued addendums) is available at www.whitehouse.gov/omb/grants_circulars/.

guidance for financial audits, and generally only as they relate to audits of financial statements prepared in conformity with generally accepted accounting principles or an other comprehensive basis of accounting and audits conducted in accordance with the Single Audit Act Amendments of 1996 and OMB Circular A-133. Therefore, any references in *Government Auditing Standards* to attestation engagements or performance audits are not included in this guide.

1.03 The requirements and guidance in *Government Auditing Standards* apply to audits of governmental entities, programs, activities, and functions, and of governmental assistance administered by contractors, nonprofit entities, and other nongovernmental entities, when the use of *Government Auditing Standards* is required or is voluntarily followed. Entities for which an auditor may need to apply *Government Auditing Standards* when auditing financial statements include federal, state, and local governments; NFPs; health care organizations; and organizations with mortgage banking, real estate, or student lending and servicing activities. The Single Audit Act Amendments of 1996 and Circular A-133 require the use of *Government Auditing Standards*. As discussed in chapter 5, "Overview of the Single Audit Act, Circular A-133, and the *Compliance Supplement*," of this guide, the Single Audit Act Amendments of 1996 and Circular A-133 apply to nonfederal entities that expend \$500,000 or more of federal awards in a fiscal year. Other laws, regulations, agreements, contracts, or other authoritative sources could require the use of *Government Auditing Standards*. For example, state and local laws and regulations may require auditors of state and local governments to follow *Government Auditing Standards*. Federal audit guidelines pertaining to program requirements, such as those issued for Housing and Urban Development programs and Student Financial Aid programs, also may require the use of *Government Auditing Standards*.

1.04 This guide discusses the requirements of GAAS to the extent necessary to explain the related requirements of *Government Auditing Standards*. The relevant professional standards and applicable Audit and Accounting Guides, such as *Health Care Entities*, *Not-for-Profit Entities*, and *State and Local Governments*, provide additional information on GAAS requirements.

1.05 Auditing guidance included in an AICPA Audit Guide is recognized as an interpretive publication pursuant to AU section 150, *Generally Accepted Auditing Standards* (AICPA, *Professional Standards*, vol. 1). Interpretive publications are not auditing standards. The guidance provides recommendations on the application of SASs to specific circumstances, in this case to audits performed in accordance with *Government Auditing Standards* and to single and program-specific audits under Circular A-133. The OMB, GAO, and AICPA promulgate applicable standards and requirements. Refer to those organizations' websites⁷ for the full text of the organizations' original standards and requirements.

1.06 In certain situations, *Government Auditing Standards* contains different requirements for internal audit organizations. For example, *Government Auditing Standards* paragraph 5.18 footnote 69, does not require internal audit organizations to report fraud, illegal acts (violations of laws and regulations), violations of provisions of contracts or grant agreements, or abuse directly to

⁷ See footnotes 2, 4, 5 and 6 in paragraph 1.01 for links to applicable guidance. Also see the AICPA website at www.aicpa.org and the Governmental Audit Quality Center website at www.aicpa.org/InterestAreas/GovernmentalAuditQuality/Pages/GAQC.aspx.

parties outside the entity unless required by law, rule, regulation, or policy. This guide discusses the *Government Auditing Standards* guidance relevant to independent auditors, and does not highlight the different requirements for internal audit organizations. Refer to *Government Auditing Standards* for possible different requirements for internal audit organizations.

1.07 This guide is organized into 2 parts that discuss important considerations for audits under *Government Auditing Standards* and for single audits and program-specific audits under Circular A-133. Each part presents chapters with topics relating to planning, performing, evaluating the results of, and reporting on those audits. See the table of contents for the specific topics addressed in each part and chapter.

1.08 This guide is not a complete manual of procedures, and *Government Auditing Standards* states that the auditor must use professional judgment in planning and performing audit engagements and reporting the results. Because of the variety and complexity of the laws and regulations that govern audits performed under *Government Auditing Standards* and Circular A-133, the procedures included in this guide cannot cover all the circumstances or conditions that would be encountered in the audits of every entity. The auditor must use professional judgment to tailor procedures to meet the conditions of the particular engagement, so that the audit objectives may be achieved.

1.09 Certain states have imposed additional audit requirements related to state or local financial assistance. Further, pass-through entities may impose additional audit requirements on their subrecipients related to the financial assistance passed through. (See paragraph 1.10 for information regarding terms used.) The guidance in this guide generally does not discuss or extend to those requirements.

Definitions

1.10 The terms used in this guide are intended to be consistent with the definitions in *Government Auditing Standards* the Single Audit Act Amendments of 1996, and Circular A-133. Similarly, the term *not-for-profit entity* (which has replaced the term *not-for-profit organization* beginning with this edition of the guide) as used in this guide is consistent with the definition of the term *nonprofit organization* in Circular A-133 and includes not-for-profit institutions of higher education, hospitals, and other health care providers.

Adherence to Professional Standards and Requirements

1.11 AICPA Interpretation No. 501-3, "Failure to follow standards and/or procedures or other requirements in governmental audits," under Rule 501, *Acts Discreditable* (AICPA, *Professional Standards*, vol. 2, ET sec. 501 par. .04), states that when an auditor undertakes an audit of government grants, government units, or other recipients of government monies and agrees to follow specified government audit standards, guides, procedures, statutes, rules, and regulations, the auditor is obligated to follow those standards or guidelines in addition to GAAS. An AICPA member auditor's failure to do so is an act discreditable to the profession and a violation of Rule 501, unless the auditor's report discloses that those rules were not followed and the reasons therefore.

1.12 Auditors should exercise due professional care in ensuring that they, and management, understand the type of engagement to be performed.

Chapter 2, "Planning Considerations of Government Auditing Standards," of this guide further discusses GAAS and *Government Auditing Standards* requirements for establishing an understanding with the auditee, which includes communicating with the auditee, through a written communication, the auditor's understanding of the services to be performed.

1.13 Management is responsible for obtaining audits that satisfy relevant legal, regulatory, or contractual requirements. If during a GAAS audit of the financial statements, the auditor becomes aware that the entity is subject to an audit requirement that may not be encompassed in the terms of the engagement, the auditor should communicate to management and those charged with governance, in writing, that an audit in accordance with GAAS may not satisfy the relevant legal, regulatory, or contractual requirements. For example, the auditor will be required to make this communication if the auditor is engaged to perform an audit of an entity's financial statements in accordance with GAAS and the auditor becomes aware that, by law, regulation, or contractual agreement, the entity also is required to have an audit performed in accordance with one or more of the following:

- *Government Auditing Standards*
- The Single Audit Act and Circular A-133
- Other compliance audit requirements, such as state or local laws or program-specific audits under federal audit guides

1.14 The auditor should consider how the client's actions in response to such a communication relate to other aspects of the audit, including their potential effect on the financial statements and on the auditor's report on those financial statements. Specifically, the auditor should consider management's actions (such as not arranging for an audit that meets the applicable requirements) in relation to the guidance in AU section 317, *Illegal Acts by Clients* (AICPA, *Professional Standards*, vol. 1), and AU section 316, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1).

Part I

Government Auditing Standards *Audits*

Chapter 2

Planning Considerations of Government Auditing Standards

2.01 This chapter describes the requirements and guidance in *Government Auditing Standards* (also referred to as the Yellow Book), issued by the Comptroller General of the United States of the U.S. Government Accountability Office (GAO), for audits of financial statements. In describing those requirements and guidance, this chapter also discusses planning considerations for those audits.¹ Refer to the full text of *Government Auditing Standards* for a complete discussion of the relevant requirements.

Overview

2.02 The professional standards and guidance for financial audits contained in *Government Auditing Standards* provide a framework for conducting high quality government audits with competence, integrity, objectivity and independence. *Government Auditing Standards* also emphasizes ethical principles as the foundation, discipline, and structure behind the implementation of the standards.

2.03 *Government Auditing Standards* uses two categories of professional requirements, identified by specific words, to describe the degree of responsibility they impose on auditors and audit organizations. Footnote 4 to paragraph 1.05 of *Government Auditing Standards* states the terminology used is intended to be consistent with AU section 120, *Defining Professional Requirements in Statements on Auditing Standards* (AICPA, *Professional Standards*, vol. 1). Unconditional requirements, with which auditors are required to comply, are indicated by the use of the words *must* or *is required*. Presumptively mandatory requirements are also required to be complied with. However, in rare circumstances auditors may depart from them provided they document their justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the objectives of the presumptively mandatory requirement. *Government Auditing Standards* uses the word *should* to specify a presumptively mandatory requirement. In December 2007, the GAO issued *Government Auditing Standards: Implementation Tool—Professional Requirements Tool for Use in Implementing Requirements Identified by "Must" and "Should" in the July 2007 Revision of Government Auditing Standards* (GAO-08-210G, December 2007). This tool can be used by auditors and audit organizations to facilitate implementation of the standards and does not represent additional standards or requirements. The tool is intended to assist auditors with documenting compliance with *Government Auditing Standards*. This professional requirements tool lists the requirements

¹ AU section 311, *Planning and Supervision* (AICPA, *Professional Standards*, vol. 1), discusses the auditor's responsibilities for planning and supervision in an audit of financial statements in accordance with generally accepted auditing standards (GAAS). Various AICPA Audit and Accounting Guides, including *Health Care Entities*, *Not-for-Profit Entities*, and *State and Local Governments*, also discuss planning considerations for audits of financial statements performed under GAAS.

for audit organizations and auditors included in the July 2007 revision of *Government Auditing Standards*.

2.04 *Government Auditing Standards* also contains explanatory material which is intended to be descriptive rather than required. The words *may*, *might*, and *could* are used to provide further explanation and guidance on the professional requirements or to identify and describe other procedures or actions relating to the auditors' or audit organizations' activities. How and whether to carry out procedures or actions described in explanatory material depends on the exercise of professional judgment consistent with the objectives of the standard.

2.05 In conducting audits of financial statements in accordance with *Government Auditing Standards*, the auditor assumes certain responsibilities beyond those of audits performed in accordance with generally accepted auditing standards (GAAS). *Government Auditing Standards* describes ethical principles, establishes general standards, and establishes additional fieldwork and reporting standards beyond those required by GAAS. For example, *Government Auditing Standards* requires additional reporting on internal control over financial reporting, compliance with laws, regulations, and provisions of contracts or grant agreements,² fraud, and abuse, which affect audit procedures performed. Specifically, in addition to an auditor's report that expresses an opinion or disclaimer of opinion on the financial statements as required by GAAS,³ a written report on internal control over financial reporting and on compliance and other matters is required under *Government Auditing Standards*. Chapters 4 and 5 of *Government Auditing Standards* discuss the additional fieldwork and reporting responsibilities that specifically relate to internal control, compliance, fraud and abuse.

Relationship of Other Professional Standards and Government Auditing Standards

2.06 For financial audits, *Government Auditing Standards* incorporates the fieldwork and reporting standards of GAAS and the related Statements on Auditing Standards (SASs) issued by the AICPA unless specifically excluded or modified by *Government Auditing Standards*.⁴ In conducting audits of financial statements in accordance with *Government Auditing Standards*, the auditor should be aware of and consider interpretive publications applicable to

² Paragraph 4.28 footnote 59 of *Government Auditing Standards* and paragraph .02 of AU section 317, *Illegal Acts by Clients* (AICPA, *Professional Standards*, vol. 1), defines the term *illegal acts* as violations of laws or governmental regulations. As indicated in chapter 3, "Financial Statement Audit Considerations of *Government Auditing Standards*," of this guide, it generally has been interpreted under GAAS that the term *laws and regulations* in AU section 317 implicitly includes provisions of contracts or grant agreements. This guide sometimes collectively refers to laws, regulations, and provisions of contracts and grant agreements as *compliance requirements* and to illegal acts and violations of provisions of contracts or grant agreements as *noncompliance* or *instances of noncompliance*.

³ As explained in the AICPA Audit and Accounting Guide *State and Local Governments*, the auditor generally expresses or disclaims an opinion on a government's basic financial statements by providing an opinion or disclaimer of opinion on each opinion unit required to be presented in those financial statements. In addition, the auditor may provide opinions or disclaimers of opinions on additional opinion units if engaged to set the scope of the audit and assess materiality at a more detailed level than by the opinion units required for the basic financial statements. Throughout this guide, the use of the singular terms *opinion* and *disclaimer of opinion* encompasses the multiple opinions and disclaimers of opinion that generally will be provided on a government's financial statements.

⁴ To date, the Comptroller General has not excluded any fieldwork or reporting standards or related Statements on Auditing Standards (SASs).

his or her audit, as discussed in AU section 150, *Generally Accepted Auditing Standards* (AICPA, *Professional Standards*, vol. 1). Interpretive publications other than this guide that affect the audits of financial statements of entities that are subject to *Government Auditing Standards* include the AICPA Audit and Accounting Guides, such as *Health Care Entities*, *Not-for-Profit Entities*, and *State and Local Governments*.

2.07 Auditors may also use *Government Auditing Standards* in conjunction with Public Company Accounting Oversight Board⁵ or International Auditing and Assurance Standards Board standards even though those standards are not incorporated into *Government Auditing Standards*. (See paragraph 1.15 of *Government Auditing Standards*). Auditors may also cite the use of other standards in their audit reports, as appropriate. If the auditor is citing compliance with *Government Auditing Standards* and inconsistencies exist between *Government Auditing Standards* and other standards cited, the auditor should use *Government Auditing Standards* as the prevailing standard for conducting the audit and reporting the results.

Government Auditing Standards—Ethical Principles

2.08 *Government Auditing Standards* emphasizes the importance of ethical principles⁶ through a chapter devoted entirely to those principles. Chapter 2, "Ethical Principles in Government Auditing," begins by stating "Because auditing is essential to government accountability to the public, the public expects audit organizations and auditors who conduct their work in accordance with GAGAS (*Government Auditing Standards*) to follow ethical principles." Although the five principles presented in the chapter do not contain additional requirements, they do provide the foundation, discipline, and structure as well as the climate which influence the application of *Government Auditing Standards*.

⁵ Some entities are required to have an audit conducted in accordance with standards issued by both the Public Company Accounting Oversight Board (PCAOB), as required by the Sarbanes-Oxley Act of 2002, and the Comptroller General, as contained in *Government Auditing Standards* (also referred to as the Yellow Book). Some examples include lending institutions that participate in federally sponsored loan programs such as housing and education. The Government Accountability Office (GAO) has issued guidance on the Yellow Book page of its website at www.gao.gov/govaud/ybk01.htm titled "Guidance on Complying with Government Auditing Standards Reporting Requirements for the Report on Internal Control for Audits of Certain Entities Subject to the Requirements of the Sarbanes-Oxley Act of 2002 and *Government Auditing Standards*." This GAO guidance states that it recognizes that the use of PCAOB's framework for assessing deficiencies in internal control could result in inconsistencies in reporting on internal control under *Government Auditing Standards*. Guidance is available to facilitate the reporting of deficiencies in internal control identified during audits conducted under both PCAOB and *Government Auditing Standards* to ensure the consistency of information included in the *Government Auditing Standards* report on internal control and to assist auditors in complying with *Government Auditing Standards*.

In November 2008, GAO issued "Interim Guidance on Reporting Deficiencies in Internal Control for GAGAS Financial Audits and Attestation Engagements," which states that auditors may satisfy the internal control reporting requirements in *Government Auditing Standards* by including in the *Government Auditing Standards* report all identified significant deficiencies and material weaknesses following the definitions and requirements from SAS No. 115, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 325). Because the definitions of *significant deficiencies* and *material weaknesses* are uniform between PCAOB and SAS No. 115, this interim guidance is relevant for those entities that are expected to apply both PCAOB standards and *Government Auditing Standards*. See the GAO website for further information.

⁶ The bylaws of the AICPA require its members to adhere to the Code of Professional Conduct (AICPA, *Professional Standards*, vol. 2). The code consists of two sections, the principles and the rules. The principles provide the framework for the rules, which govern the performance of professional services by members.

by audit organizations and its auditors. The five ethical principles are as follows:

- a. The public interest
- b. Integrity
- c. Objectivity
- d. Proper use of government information, resources, and position
- e. Professional behavior

These principles help guide the work of auditors who conduct audits in accordance with *Government Auditing Standards* and provide the overall framework for the application of *Government Auditing Standards*, including general standards, fieldwork standards and reporting standards. See chapter 2 of *Government Auditing Standards* for a full discussion of these principles.

Government Auditing Standards—General Standards

2.09 The general standards found in chapter 3 of *Government Auditing Standards*, along with the overarching ethical principles found in chapter 2 of *Government Auditing Standards*, establish a foundation for credibility of auditor's work. The general standards applicable to *Government Auditing Standards* are as follows:

- *Independence.* In all matters relating to the audit work, the audit organization and the individual auditor, whether government or public, must be free from personal, external, and organizational impairments to independence, and must avoid the appearance of such impairments of independence.
- *Professional Judgment.* Auditors must use professional judgment in planning and performing audits and in reporting the results.
- *Competence.* The staff assigned to perform the audit must collectively possess adequate professional competence for the tasks required.
- *Quality control and assurance.* Each audit organization performing audits in accordance with *Government Auditing Standards* must (a) establish a system of quality control that is designed to provide the audit organization with reasonable assurance that the organization and its personnel comply with professional standards and applicable legal and regulatory requirements, and (b) have an external peer review at least once every three years.

Independence

2.10 In a GAAS audit, members are required to comply with the AICPA's Code of Professional Conduct Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .01). For audits conducted in accordance with *Government Auditing Standards*, auditors and audit organizations are subject to additional independence rules that are in some cases very similar to the AICPA independence rules and in other cases more restrictive. *Government Auditing Standards* employs a principles based approach to independence supplemented with certain safeguards for matters such as the performance of nonaudit services. *Government Auditing Standards* states that auditors and audit organizations must be free from personal, external, and organizational

impairments to independence and must avoid the appearance of such impairments of independence. If an audit organization is not independent, paragraph 3.04 of *Government Auditing Standards* states that the auditor should decline to perform the work. *Government Auditing Standards* allows an exception for government auditors who have a legislative requirement or for other reasons cannot decline the work. In these situations, government auditors must disclose the impairment and modify the compliance statement in the auditor's report.⁷ The remainder of this section of the guide highlights the *Government Auditing Standards* independence requirements.

2.11 Auditors and audit organizations must maintain independence so that their opinions, findings, conclusions, judgments, and recommendations will be impartial and viewed as impartial by objective third parties with knowledge of the relevant information. The independence rules in chapter 3 of *Government Auditing Standards* address when auditors and their organizations are independent from the organizations they audit by defining when any of the three general classes of impairments (personal, external, and organizational) to independence exist.^{8,9} *Government Auditing Standards* adopts an engagement-team-focused approach to independence for matters such as financial interests of an individual auditor, not unlike the AICPA's Code of Professional Conduct. Audit organizations should include as part of their quality control system procedures to identify and resolve personal impairments and help ensure compliance with *Government Auditing Standards* independence requirements. In addition, audit organizations should maintain documentation of the steps taken to identify potential personal independence impairments.

2.12 Paragraph 3.05 of *Government Auditing Standards* states that when auditors use the work of a specialist, auditors should assess the specialist's ability to perform the work and report results impartially as it relates to their relationship with the program or entity under audit. If the specialist's independence is impaired, auditors should not use the work of that specialist.

2.13 In planning the audit, the auditor should consider the effects of any nonaudit services performed on the auditor's independence for current, future and planned audit service. Audit organizations may perform other professional services (nonaudit services) that are not performed in accordance with *Government Auditing Standards*. In that case, audit organizations must evaluate whether providing the nonaudit services creates an independence impairment either in fact or appearance with respect to the entities it audits. Two overarching principles apply to auditor independence when assessing the impact of performing a nonaudit service to an audited program or entity. The first states that audit organizations must not provide nonaudit services that involve

⁷ Paragraph 3.06 of *Government Auditing Standards* explains what action should be taken in the case where an impairment to independence is identified after the audit report is issued. Any related notification to management, those charged with governance, regulatory agencies and others should be made in writing.

⁸ The GAO has issued a question and answer document titled *Answers to Independence Standard Questions*, which responds to questions related to the independence standard's implementation time frame, underlying concepts, and application in specific nonaudit circumstances. That document is on the Yellow Book page of the GAO's website at www.gao.gov/govaud/ybk01.htm. A document that references the information in the publication *Answers to Independence Standard Questions* to the 2007 revision of *Government Auditing Standards* is also available on the GAO website.

⁹ *Government Auditing Standards* also provides criteria for when governmental audit organizations are organizationally independent from the auditee for purposes of external and internal reporting.

performing management functions or making management decisions. The second states that audit organizations must not audit their own work or provide nonaudit services in situations in which the nonaudit services are significant or material to the subject matter of the audits.¹⁰

2.14 *Government Auditing Standards* states that nonaudit services provided to entities it audits generally fall into three categories:¹¹

- Nonaudit services that do not impair an audit organization's independence and therefore do not require compliance with supplemental safeguards. (Paragraphs 3.26–.27 of *Government Auditing Standards*)
- Nonaudit services that would not impair an audit organization's independence as long as the audit organization complies with the supplemental safeguards described in paragraph 2.15. (Paragraph 3.28 of *Government Auditing Standards*)
- Nonaudit services that do impair an audit organization's independence. Compliance with the supplemental safeguards will not overcome this impairment. (Paragraph 3.29 of *Government Auditing Standards*)

2.15 Performing nonaudit services described in paragraph 3.28 of *Government Auditing Standards* will not impair independence if the overarching principles described in paragraph 2.13 are not violated and the supplemental safeguards described in chapter 3 of *Government Auditing Standards* are implemented. For this category of nonaudit services the audit organization should comply with each of the following safeguards:

- Document its consideration of the nonaudit services, including its conclusions about the impact on independence
- Establish in writing an understanding with the audited entity regarding the objectives, scope of work, and product or deliverables of the nonaudit service and management's responsibility for (a) the subject matter of the nonaudit services, (b) the substantive outcomes of the work, and (c) making any decisions that involve management functions related to the nonaudit service and accepting full responsibility for such decisions
- Exclude personnel who provided the nonaudit services from planning, conducting, or reviewing audit work in the subject matter of the nonaudit service^{12,13}
- Do not reduce the scope and extent of the audit work below the level that would be appropriate if the nonaudit service were performed by an unrelated party

¹⁰ Paragraph 3.22 footnote 28 of *Government Auditing Standards* states that the concepts of significance and materiality include quantitative as well as qualitative measures in relation to the subject matter of the audit.

¹¹ Appendix I paragraphs A3.02 and A3.03 of *Government Auditing Standards* provide examples of nonaudit services that are generally unique to audit organizations in government entities.

¹² Personnel who provided the nonaudit service are permitted to convey to the audit team the documentation and knowledge gained about the audited entity and its operations.

¹³ As stated in question 30 of the GAO publication *Answers to Independence Standard Questions*, in applying the safeguards and for reasons of efficiency and practicality, if the nonaudit service involves a total of 40 hours or fewer as it relates to a specific audit engagement, the safeguard associated with

(continued)

Professional Judgment

2.16 *Government Auditing Standards* states that auditors must use professional judgment in planning and performing audits and in reporting the results. Although this standard is similar to the AICPA standard on due professional care in AU section 230, *Due Professional Care in the Performance of Work* (AICPA, *Professional Standards*, vol. 1), *Government Auditing Standards* expands the discussion of professional judgment as it relates to its importance in audit engagements. Professional judgment includes exercising reasonable care and professional skepticism. Reasonable care concerns acting diligently in accordance with professional standards and ethical principles. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of evidence. Auditors should document significant decisions affecting the audit objectives, scope, and methodology, findings, conclusions, and recommendations resulting from professional judgment.

2.17 Chapter 3 of *Government Auditing Standards* provides further guidance regarding the use of professional judgment in the audit process. Items that are among those described by *Government Auditing Standards* are as follows:

- A critical component of an audit is the use of the auditor's professional knowledge, skills, and experience to diligently perform, in good faith and with integrity, the gathering of information and the objective evaluation of the sufficiency and appropriateness of evidence.
- Professional judgment represents the application of the collective knowledge, skills, and experiences of all the personnel involved with an assignment, as well as the professional judgment of individual auditors. Using professional judgment in all aspects of carrying out their professional responsibilities, including following the independence standards, maintaining objectivity and credibility, assigning competent audit staff, defining the scope of work, evaluating and reporting the results of the work, and maintaining appropriate quality control over the assignment process is essential to performing and reporting on an audit.
- Using professional judgment is important in determining the required level of understanding of the audit subject matter and related circumstances. This includes consideration about whether the audit team's collective experience, training, knowledge, skills, abilities, and overall understanding are sufficient to assess the risks that the subject matter under audit may contain a significant inaccuracy or could be misinterpreted.
- Considering the risk level of each assignment, including the risk that they may come to an improper conclusion is another important issue. In this context, exercising professional judgment in determining the sufficiency and appropriateness of evidence to be used to support the findings and conclusions based on the audit

(footnote continued)

precluding personnel who provided the nonaudit service from performing related audit work would not be required. However, the other safeguards described in this paragraph would apply. Auditors and audit organizations need to consider related services that may have been performed under separate contracts or separate engagements in applying this de minimis criteria.

objectives and any recommendations reported is an integral part of the audit process.

Competence

2.18 *Government Auditing Standards* states that the staff assigned to perform the audit must collectively possess adequate professional competence for the tasks required.¹⁴ *Government Auditing Standards* is generally consistent with the AICPA's general standard on auditor qualification in AU section 210, *Training and Proficiency of the Independent Auditor* (AICPA, *Professional Standards*, vol. 1). *Government Auditing Standards* states that an audit organization should have a process for recruitment, hiring, continuous development, assignment, and evaluation of staff to maintain a competent workforce. One of the areas that process should address is continuing professional education (CPE).

2.19 Auditors performing work under *Government Auditing Standards*, including planning, directing, performing field work, or reporting on an audit engagement, should maintain their professional competence through CPE. Therefore, each auditor performing work under *Government Auditing Standards* should complete, every 2 years, at least 24 hours of CPE that directly relates to government auditing, the government environment, or the specific or unique environment in which the audited entity operates. Those auditors who are involved in any amount of planning, directing, or reporting on assignments using *Government Auditing Standards* and those auditors who are not involved in those activities but charge 20 percent or more of their time annually to *Government Auditing Standards* related engagements should also obtain at least an additional 56 hours of CPE (for a total of 80 hours of CPE in every 2 year period) that enhances the auditor's professional proficiency to perform audits or attestation engagements. At least 20 of the 80 hours should be completed in any one year of the two-year period. *Government Auditing Standards* also states that the audit organization should have quality control procedures to help ensure that auditors meet the continuing education requirements, including documentation of the CPE completed.

2.20 The GAO has issued *Guidance on GAGAS Requirements for Continuing Professional Education*,¹⁵ which provides additional guidance to auditors and audit organizations in implementing the CPE requirements prescribed by *Government Auditing Standards*. Among other things, the guidance discusses who is subject to the CPE requirements; the programs, activities, subjects and topics that qualify as acceptable CPE; how compliance with CPE requirements is measured; how to measure CPE hours; and how CPE requirements are to be administered. The guidance states that auditors hired or assigned to a *Government Auditing Standards* audit engagement after the beginning of an audit organization's two-year CPE period should complete a prorated number of CPE

¹⁴ Paragraph 3.43 of *Government Auditing Standards* provides a listing of the types of technical knowledge and skills that staff members should collectively possess. In addition, auditors performing financial audits should be knowledgeable in generally accepted accounting principles, the AICPA standards of fieldwork and reporting, and the related SASs and their application. If another set of standards is used in conjunction with *Government Auditing Standards*, the auditor should be knowledgeable and competent in applying those standards.

¹⁵ This guidance, *Government Auditing Standards: Guidance on GAGAS Requirements for Continuing Professional Education*, GAO-05-568G (Washington, D.C., April 2005), can be found on the Yellow Book page of the GAO's website at www.gao.gov/govaud/ybk01.htm.

hours. In addition, the guidance provides an explanation of how to calculate the number of hours required.

2.21 *Government Auditing Standards* does not require external specialists to meet its CPE requirements, but states that they should be qualified and maintain professional competence in their areas of specialization. Auditors who use the work of external specialists should assess the professional qualifications and document their findings and conclusions. Internal specialists who are part of the audit organization and perform as a member of the audit team should comply with *Government Auditing Standards*, including the CPE requirements.

Quality Control and Assurance¹⁶

2.22 Each audit organization performing audits in accordance to *Government Auditing Standards* must (a) establish a system of quality control that is designed to provide the audit organization with reasonable assurance that the organization and its personnel comply with professional standards and applicable legal and regulatory requirements, and (b) have an external peer review at least once every three years.¹⁷ Paragraphs 3.50–.63 of *Government Auditing Standards* address the general standard for quality control and assurance, including the requirements for a system of quality control that should be collectively addressed in its policies and procedures. The audit organization must document its quality control procedures and communicate the policies and procedures to its personnel. The audit organization also should document compliance with its quality control policies and procedures and should maintain the documentation for a period of time sufficient to enable those performing monitoring procedures and peer reviews to evaluate the extent of the audit organization's compliance with its quality control policies and procedures. The audit organization should analyze and summarize the results of its monitoring procedures at least annually including identification of any systemic improvements and recommendations for corrective action.

2.23 *Government Auditing Standards* also contains requirements related to external peer review. Audit organizations performing audits in accordance with *Government Auditing Standards* must have an external peer review performed by reviewers independent of the audit organization being reviewed at least once every three years.¹⁸ The external peer review should be sufficient in scope to provide a reasonable basis for determining whether the reviewed audit organization's internal quality control system was suitably designed and whether the audit organization is complying with its quality control policies and

¹⁶ The Auditing Standards Board of the AICPA issues Statements of Quality Control Standards (SQCSs) that must be adhered to by firms that are enrolled in an AICPA-approved practice-monitoring program. See QC section 10, *A Firm's System of Quality Control* (AICPA, *Professional Standards*, vol. 2), for the applicable guidance. Therefore, when performing audits under *Government Auditing Standards*, such firms must adhere to both the SQCSs and the quality control and assurance requirements in *Government Auditing Standards*, as described in this section.

¹⁷ *Government Auditing Standards* provides that audit organizations have an external peer review conducted within three years from the date of the start of field work of their first assignment in accordance with *Government Auditing Standards*. Subsequent external peer reviews should be conducted every three years. Extensions of the deadlines for submitting the peer review report exceeding three months beyond the due date are granted by the entity that administers the peer review program and GAO.

¹⁸ An audit organization's noncompliance with the external peer review requirement (paragraph 3.50(b) of *Government Auditing Standards*), results in a modified *Government Auditing Standards* compliance statement. However, the organization's compliance or noncompliance with the requirements for a system of quality control are tested and reported on as a part of the peer review process and do not impact the *Government Auditing Standards* compliance statement.

procedures in order to provide the audit organization with reasonable assurance of conforming with applicable professional standards. Paragraphs 3.57–.63 of *Government Auditing Standards* contain guidance for the peer review team in conducting a review.

2.24 An audit organization seeking to enter into a contract to perform an engagement in accordance with *Government Auditing Standards* should provide their most recent external peer review report and any letter of comment to the party contracting for the audit. They also should provide subsequent reports and letters received during the period of the contract to that party. Also, an external audit organization (as defined in paragraphs 3.13–.15 of *Government Auditing Standards*) should make its most recent peer review report publicly available (for example, on an external website or a publicly available file designed for public transparency of peer review results). If these options are not available to the audit organization, it should use the same transparency mechanism it uses to make other information public, and also provide the peer review report to others upon request. Government audit organizations should also communicate the overall results and the availability of their external peer review reports to appropriate oversight bodies. Auditors who are relying on another audit organization's work should request a copy of that organization's peer review report and any letter of comment, and that audit organization should provide the documents when requested. This guide recommends that auditors consider including information about requests for other organizations' reports and letters and the receipts and provision of reports and letters in the audit documentation.

Government Auditing Standards—Fieldwork Standards

2.25 *Government Auditing Standards* incorporate the AICPA fieldwork standards and the related SASs into its standards by reference. The AICPA fieldwork standards, as found in AU section 150 are as follows:

- The auditor must adequately plan the work and must properly supervise any assistants.
- The auditor must obtain a sufficient understanding of the entity and its environment, including its internal control, to assess the risks of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures.
- The auditor must obtain sufficient appropriate audit evidence by performing audit procedures to afford a reasonable basis for an opinion regarding the financial statements under audit.

2.26 In addition to the AICPA standards, *Government Auditing Standards* establishes additional fieldwork standards for auditors to comply with when citing Government Auditing Standards in their audit reports. These additional standards relate to

- auditor communication during planning;
- previous audits and attestation engagements;
- detecting material misstatements resulting from violations of provisions of contracts or grant agreements, or from abuse;
- developing elements of a finding; and
- audit documentation.

Auditor Communication

2.27 *Government Auditing Standards* states that the auditor should communicate with the audited entity his or her understanding of the services to be performed and document that understanding through a written communication. This information regarding the nature, timing, and extent of planned testing and reporting and the level of assurance to the parties identified in paragraph 2.29 is part of the planning stages of an audit. (See paragraphs 2.40–.41 for a discussion of the GAAS guidance as found in AU section 311, *Planning and Supervision* [AICPA, *Professional Standards*, vol. 1], related to this communication.)

2.28 *Government Auditing Standards* paragraphs 4.05–.08 broaden both the parties included in the communication and the information to be communicated. *Government Auditing Standards* states that the required auditor communication should include the following additional information:

- The nature of planned work and level of assurance to be provided related to internal control over financial reporting and compliance with laws, regulations, and provisions of contracts or grant agreements
- Potential restrictions on the auditor's reports

The discussion in paragraph 4.07 of *Government Auditing Standards* may be helpful to auditors in explaining their responsibilities for testing and reporting on internal control over financial reporting and on compliance with laws, regulations, and provisions of contracts or grant agreements.

2.29 *Government Auditing Standards* also broadens the parties included in the communication. The auditor should communicate the required information to the following:

- Management and those charged with governance¹⁹
- The individuals contracting for or requesting the audit services, in situations where the auditor is performing the audit under a contract with a party other than the auditee, or pursuant to a third-party request
- The legislative members or staff who have oversight of the auditee—when the auditor is performing the audit pursuant to a law, regulation or contract with the specific legislative committee

In those situations where there is not a single individual or group that both oversees the strategic direction of the entity and the fulfillment of its accountability obligations or when the identity of those charged with governance is not clearly evident, auditors should document the process followed and conclusions reached for identifying the appropriate individuals to receive the required auditor communications.

2.30 *Government Auditing Standards* also states that if an audit is terminated before it is complete, and an audit report is not issued, auditors should

¹⁹ Management and those charged with governance would normally include the head of the organization, the audit committee or board of directors or other equivalent oversight body in the absence of an audit committee, and the individual who possesses a sufficient level of authority such as the chief financial officer.

document the results of the work to the date of termination and explain the reasons why the audit was terminated. Determining whether and how to communicate the reason for terminating the audit to those charged with governance, appropriate officials of the audited entity, the entity contracting for the audit, and other appropriate officials will depend on the facts and circumstances, and is a matter of professional judgment.

Considering the Results of Previous Audits and Attestation Engagements

2.31 Paragraph 4.09 of *Government Auditing Standards* states that auditors should evaluate whether the audited entity has taken appropriate corrective action to address findings and recommendations from previous engagements that could have a material effect on the financial statements. As part of planning, auditors should ask management of the audited entity to identify previous audits, attestation engagements and other studies that relate to the audit objectives, including whether related recommendations have been implemented. This information should be used in assessing risk and determining the nature, timing, and extent of current audit work, including determining the extent to which testing the implementation of the corrective actions is applicable to the current audit objectives.²⁰

Detecting Material Misstatements Resulting From Violations of Provisions of Contracts and Grant Agreements and Abuse

2.32 *Government Auditing Standards* contains an additional fieldwork standard which states that auditors should design the audit to provide reasonable assurance of detecting misstatements resulting from violations of provisions of contracts or grant agreements and that could have a direct and material effect on the determination of financial statement amounts or other financial data significant to the audit objectives.²¹ However, it generally has been interpreted under GAAS that the phrase *laws and regulations* in AU section 317, *Illegal Acts by Clients* (AICPA, *Professional Standards*, vol. 1), implicitly includes provisions of contracts or grant agreements. Thus, the auditor's responsibility in an audit of financial statements with regard to detecting material misstatements resulting from violations of provisions of contracts or grant agreements under *Government Auditing Standards* equates to the auditor's responsibility under GAAS. Chapter 3, "Financial Statement Audit Considerations of *Government Auditing Standards*," of this guide further discusses this issue and related auditing procedures.

2.33 Paragraphs 4.12–.13 of *Government Auditing Standards* contain a discussion of abuse and its potential effect on audits of financial statements. Chapter 3 of this guide discusses the standard concerning abuse and related auditing procedures.

²⁰ Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133), contains additional requirements for follow-up on prior audit findings. See chapter 10, "Compliance Auditing Applicable to Major Programs," and chapter 13, "Auditor Reporting Requirements and Other Communication Considerations in a Single Audit," of this guide.

²¹ The reference in *Government Auditing Standards* to "other financial data significant to the audit objectives" relates to auditing procedures on financial data outside of the basic financial statements. For example, it may relate to required supplementary information (RSI) and supplementary information other than RSI (known as SI). It also relates to financial audits other than the audits of financial statements, including audits conducted in accordance with Circular A-133.

Developing Elements of a Finding

2.34 *Government Auditing Standards* discusses audit findings, which may involve deficiencies in internal control, fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse. When auditors identify deficiencies, they should plan and perform procedures to develop the elements of the findings that are relevant and necessary to achieve the audit objectives. *Government Auditing Standards* discusses the elements of an audit finding in paragraphs 4.15–.18. They are criteria, condition, cause, and effect (or potential effect). Chapter 4, "Auditor Reporting Requirements and Other Communication Considerations of *Government Auditing Standards*," of this guide further discusses audit findings as they relate to *Government Auditing Standards*. (Chapter 13, "Auditor Reporting Requirements and Other Communication Considerations in a Single Audit," of this guide discusses applying the elements of a finding in reporting the results of a single audit.)

Audit Documentation

2.35 AU section 339, *Audit Documentation* (AICPA, *Professional Standards*, vol. 1), states that an auditor must prepare audit documentation in sufficient detail to provide a clear understanding of the work performed, the audit evidence obtained and its source, and the conclusions reached. The auditor should prepare audit documentation that enables an experienced auditor, having no previous connection to the audit, to understand the nature, timing, extent, results, and conclusions of auditing procedures performed, and that the accounting records agree to or can be reconciled with the audited financial statements or other audited financial information. AU section 339 contains guidance on documenting significant findings or issues; identifying the preparer and reviewer of audit documentation; documenting specific items tested; documenting departures from relevant SASs; revising audit documentation after the date of the auditor's report; and ownership and confidentiality of audit documentation. Also, auditors should complete audit documentation within 60 days of, and retain documentation for at least 5 years from, the audit report release date. Documentation must not be deleted or discarded during this retention period. However, certain additions made in accordance with AU section 339 may be made to the documentation after the report release date or the documentation completion date. See also appendix A, "Audit Documentation Requirements in Other Statements on Auditing Standards," in AU section 339.

2.36 In addition to the requirements found in AU section 339, *Government Auditing Standards* discusses several other issues related to audit documentation. *Government Auditing Standards* states that before the report is issued, auditors should document evidence of supervisory review of the work performed that supports findings, conclusions, and recommendations contained in the audit report. Also, any departure from *Government Auditing Standards* requirements due to law, regulation, scope limitations, restrictions on access to records, or other issues impacting the audit should be documented along with the impact on the audit and the auditors' conclusions. This applies to both mandatory and presumptively mandatory requirements.

2.37 *Government Auditing Standards* states that policies and procedures should be established for the safe custody and retention of audit documentation for a time sufficient to satisfy legal, regulatory, and administrative requirements for record retention. When audit documentation is retained electronically, the audit organization should establish information systems controls

concerning accessing and updating the audit documentation. Policies and procedures should also be developed to deal with requests by outside parties to obtain access to audit documentation, especially when an outside party attempts to obtain information indirectly through the auditor rather than directly from the audited entity.

2.38 *Government Auditing Standards* contains a discussion of auditors using the work of other auditors to avoid duplication of efforts in auditing programs of common interest. Cooperation between parties is encouraged. Auditors should make appropriate individuals, and audit documentation, available upon request (subject to applicable laws and regulations) and in a timely manner to other auditors or reviewers. This may be facilitated by contractual arrangements for *Government Auditing Standards* audits that provide for full and timely access to appropriate individuals and audit documentation.

2.39 This chapter of the guide discusses specific additional audit documentation requirements of *Government Auditing Standards*. The documentation requirement and the paragraph where it is discussed is summarized as follows:

- Assurance obtained that specialists used are qualified (paragraph 2.21)
- Steps taken to identify potential personal independence impairments (paragraph 2.11)
- Consideration of providing nonaudit services, including the conclusion about the impact on independence (paragraph 2.13)
- Significant decisions affecting the audit objectives, scope, and methodology, findings, conclusions, and recommendations resulting from professional judgment (paragraph 2.16)
- CPE completed (paragraph 2.19)
- Quality control policies and procedures (paragraph 2.22)
- Evidence of supervisory review, prior to the date the audit report is issued, of the audit work performed that supports findings, conclusions, and recommendations contained in the audit report (paragraph 2.36)
- Communication with the auditee or others regarding the nature, timing, and extent of planned testing and reporting and the level of assurance (paragraph 2.27)
- Communication with the auditee or others regarding the reasons for terminating an audit (paragraph 2.30)

Additional Planning Considerations

Establishing an Understanding With the Auditee

2.40 AU section 311 states that the auditor should establish an understanding with the auditee regarding the services to be performed for each engagement. Such understanding reduces the risk that either the auditor or the auditee may misinterpret the needs or expectations of the other party. The understanding should include the objectives of the engagement, management's responsibilities, the auditor's responsibilities, and the limitations of the

engagement. The auditor should communicate this information in the form of an engagement letter. If the auditor believes an understanding with the client has not been established, he or she should decline to accept or perform the engagement.

2.41 Paragraph .09 of AU section 311 presents a listing of the matters that are generally included when the auditor establishes an understanding with the auditee regarding an audit of the financial statements. In addition to those matters, the auditor may also consider including the following information in the communication when he or she is engaged to perform an audit of financial statements in accordance with *Government Auditing Standards*:

- A description of the financial statements to be audited
- The reporting period
- The auditing standards and requirements that will be followed (that is, GAAS and *Government Auditing Standards*)
- A description of management's responsibility²² for the following:
 - Reviewing, approving, and taking responsibility for the financial statements and related notes and for acknowledging the auditor's role if the auditor has a role in preparing the trial balance and draft financial statements and related notes²³
 - Taking timely and appropriate steps to remedy fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse that the auditor reports
 - Establishing and maintaining effective internal control to help ensure that appropriate goals and objectives are met, and ensuring that management is reliable and financial information is reliable and properly recorded
 - Identifying for the auditor previous audits, attestation engagements, and other studies related to the audit objectives and the corrective actions taken to address any recommendations
 - Providing views on the auditor's current findings, conclusions, and recommendations, as well as management's planned corrective actions, for the report, and the timing and format for providing that information
- A description of management and auditor responsibilities for additional information that accompanies the basic financial statements—required supplementary information (RSI) and supplementary information other than RSI (known as SI)

²² Appendix I of *Government Auditing Standards*, section A1.08, *Management's Role in Accountability*, contains an expanded list of responsibilities.

²³ As indicated in paragraph 3.28(a) of *Government Auditing Standards*, a management representation concerning management's responsibility for this work should be obtained. To ensure that the auditee is in a position to make the required representation, the auditor may wish to include in the communication that establishes an understanding with the auditee the specific steps the auditee will take, which may include designating a qualified management-level individual to be responsible and accountable for overseeing the drafting or conversion of the financial statements.

- A statement that because the determination of abuse is subjective, *Government Auditing Standards* does not expect auditors to provide reasonable assurance of detecting abuse
- The communication with the auditee, the individuals contracting for or requesting audit services, and those charged with governance required by *Government Auditing Standards* and discussed in paragraphs 2.27–.29
- A description of the reports the auditor is expected to prepare and issue
- Report distribution responsibilities, including that copies are available for public inspection unless the report is restricted by law or regulation, or contains privileged and confidential information
- A statement that, subject to applicable laws and regulations, the audit documentation will be made available upon request to appropriate auditors and reviewers
- A copy of the audit organization's most recent external peer review report and any letter of comment as discussed in paragraph 2.24

Audit Materiality Considerations

2.42 AU section 312, *Audit Risk and Materiality in Conducting an Audit* (AICPA, *Professional Standards*, vol. 1), provides guidance on the auditor's consideration of materiality when he or she plans and performs an audit of financial statements in accordance with GAAS. Materiality, as it relates to the financial statement audit, is further discussed in the AICPA Audit and Accounting Guides, including *Not-for-Profit Entities* and *State and Local Governments*.²⁴

2.43 Chapter 4 of *Government Auditing Standards* contains guidance on materiality considerations. As noted in paragraph 4.26 footnote 55 of *Government Auditing Standards*, according to AU section 312, the consideration of materiality is a matter of professional judgment and is influenced by the auditor's perception of the needs of the users of the financial statements. Paragraph 4.26 of *Government Auditing Standards*, states "For example, in audits performed in accordance with *Government Auditing Standards*, auditors may find it appropriate to use lower materiality levels as compared with the materiality levels used in non-*Government Auditing Standards* audits because of the public accountability of government entities and entities receiving government funding, various legal and regulatory requirements, and the visibility and sensitivity of government programs."

Determining Compliance Requirements

2.44 In planning the consideration of the internal control and compliance aspects of the audit, the auditor should obtain an understanding of the possible effects on financial statements of laws and regulations that will have a direct and material effect on the determination of amounts in the entity's financial statements. The auditor should also assess whether management has

²⁴ As discussed in the AICPA Audit and Accounting Guide *State and Local Governments*, the auditor's consideration of materiality for purposes of planning, performing, evaluating the results of, and reporting on the audit of the financial statements of a state or local government is based on opinion units. See that guide for further guidance.

identified all the laws and regulations that have a direct and material effect on the financial statements. As discussed in footnote 2 in paragraph 2.05 the term *laws and regulations* includes *provisions of contract and grant agreements* when considering compliance. Chapter 3 of this guide discusses possible audit procedures to assess the completeness of management's identification of compliance requirements.

Joint Audits

2.45 Governmental entities and entities that receive governmental assistance may engage independent accounting firms on a joint venture or subcontract basis. Although there are a variety of reasons this might occur, in some cases it may be due to a legal or contractual requirement to make positive efforts to use small business, minority-owned firms, and women's business enterprises. In any case, it may be necessary to refer to the work of other auditors. AU section 543, *Part of Audit Performed by Other Independent Auditors* (AICPA, *Professional Standards*, vol. 1), and Interpretation No. 101-10, "The effect on independence of relationships with entities included in the governmental financial statements," under Rule 101 (AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .12), provides guidance for the principal auditor prior to entering into an agreement to perform a joint audit or to subcontract with another firm. The principal auditor should be satisfied that the other auditors meet the general standards of *Government Auditing Standards*, as discussed in paragraphs 2.09–.24. (See also chapter 4 for additional reporting considerations relating to other auditors.)

2.46 In some circumstances, each of the auditors participating in the audit will jointly sign the audit reports. This is appropriate only when each auditor or firm has complied with GAAS and *Government Auditing Standards* and is in a position that would justify being the only signatory of the report.

The Internal Audit Function

2.47 Another factor the auditor may need to consider when planning the audit is whether the auditee has an internal audit function and the nature of that function, including the extent to which internal auditors are involved in monitoring internal control and compliance with specified requirements. AU section 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements* (AICPA, *Professional Standards*, vol. 1), provides guidance when addressing the competence and objectivity of internal auditors; the nature, timing, and extent of work to be performed; and other related matters (for example, in obtaining an understanding of the entity's internal control over financial reporting and compliance, assessing audit risk, and performing substantive procedures). See also paragraphs 3.16–.19 of *Government Auditing Standards* for a discussion of independence as it relates to internal audit functions.

Communications With Other Entities

2.48 When professional judgment indicates it is appropriate, the auditor may communicate with grantor agencies (including pass-through entities) or federal or state auditors or other oversight entities to aid in planning the audit. As part of establishing the overall audit strategy, the auditor should document

such communications, as well as any decisions reached as a result. If a planning meeting is held, matters such as the following may be discussed:

- The audit plan
- The scope of the review and testing of internal control over financial reporting and of compliance
- The identification of grant awards and compliance requirements, including current year changes to those requirements
- The form and content of required supplemental reporting
- The status of prior-year findings and recommendations
- Recent audits or other reviews conducted by federal or state auditors or other oversight entities

Exit Conference

2.49 Upon completion of fieldwork, the auditor may hold a closing or exit conference with senior officials of the auditee. The exit conference assists the auditor in obtaining the views of responsible officials concerning the findings, conclusions, and recommendations, as well as planned corrective action, as required by *Government Auditing Standards*. (Chapter 4 of this guide discusses that *Government Auditing Standards* requirement and its guidance when auditee comments are received orally rather than in writing. *Government Auditing Standards* states that obtaining the comments in writing is preferred, but oral comments are acceptable.) That conference also provides the auditee with an advance opportunity to discuss whether planned corrective actions adequately address the auditor's recommendations and to initiate corrective action without waiting for a final audit report. In the case of decentralized operations, auditors may consider having preliminary exit meetings with directors, department heads, and other operating personnel who have direct responsibility for financial management systems and the administration of federal awards.

2.50 The auditor may also consider documenting the names of the auditors who conducted the exit conference, the names and positions of the representatives with whom exit conferences were held and any comments that they had, and other details of the discussions.

Chapter 3

Financial Statement Audit Considerations of Government Auditing Standards

Introduction

3.01 This chapter summarizes the requirements of generally accepted auditing standards (GAAS) related to the auditor's consideration of internal control over financial reporting and financial statement misstatements, including misstatements relating to compliance, in a financial statement audit.¹ As discussed in chapter 2, "Planning Considerations of *Government Auditing Standards*," of this guide, *Government Auditing Standards* incorporates those GAAS requirements.² This chapter also discusses the additional requirements of *Government Auditing Standards* in those areas and in the area of abuse.

Consideration of Internal Control Over Financial Reporting

3.02 The following paragraphs describe the requirements of GAAS and *Government Auditing Standards* applicable to the auditor's consideration of internal control over financial reporting in a financial statement audit.³

GAAS Requirements

3.03 The AICPA's second standard of fieldwork states that the auditor must obtain a sufficient understanding of the entity and its environment, including its internal control, to assess the risks of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures. The guidance found in AU section 314, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AICPA, *Professional Standards*, vol. 1), discusses the scope of understanding that the auditor must obtain relating to "the entity and its environment, including internal control." In accordance with paragraph .04 of AU section 314, the auditor should use professional judgment to determine the extent of the understanding required. The auditor's primary consideration is whether the understanding that has been obtained is sufficient

¹ Paragraph 2 of Statement on Auditing Standards (SAS) No. 117, *Compliance Audits* (AICPA, *Professional Standards*, vol. 1, AU sec. 801), clarifies that SAS No. 117 does not apply to the financial statement audit component of a compliance audit engagement. See part II of this guide for further information on the applicability and requirements of SAS No. 117.

² *Government Auditing Standards* incorporates the fieldwork and reporting standards of generally accepted auditing standards (GAAS) and the related SASs issued by the AICPA unless the Comptroller General of the United States excludes them by formal announcement. To date, the Comptroller General has not excluded any fieldwork or reporting standards or related SASs.

³ When discussing internal control, the risk assessment suite of standards (SAS Nos. 104–111) also includes a detailed discussion of understanding the entity and its environment and assessing the risks of material misstatement. Because this chapter is intended to focus on explaining the auditing requirements of *Government Auditing Standards*, it does not present full coverage of the risk assessment standards. Refer to relevant professional standards and applicable Audit and Accounting Guides, such as *Health Care Entities*, *Not-for-Profit Entities*, and *State and Local Governments*, and the Audit Guide *Assessing and Responding to Audit Risk in A Financial Statement Audit* (revised edition), for more detailed coverage of the risk assessment standards.

(1) to assess risks of material misstatement of the financial statements and (2) to design and perform further audit procedures (tests of controls and substantive tests). The auditor's understanding of the entity and its environment consists of an understanding of the following aspects:

- Industry, regulatory, and other external factors
- Nature of the entity
- Objectives and strategies and the related business risks that may result in a material misstatements of the financial statements
- Measurement and review of the entity's financial performance
- Internal control, which includes the selection and application of accounting policies

The auditor should perform the risk assessment procedures found in paragraph .06 of AU section 314 to obtain an understanding of the entity and its environment, including its internal control. These procedures include inquiries of management and others within the entity, analytical procedures, observation, and inspection. Furthermore, obtaining this understanding is a continuous, dynamic process of gathering, updating, and analyzing information throughout the audit. (Appendix A of AU section 314 contains examples of matters that the auditor may consider in obtaining an understanding of the entity and its environment.)

3.04 Although all the previously mentioned items are important to consider in an audit of financial statements, this section focuses on the topic of internal control, which is especially important in an audit of financial statements under *Government Auditing Standards* because it requires auditor reporting related to internal control over financial reporting. When obtaining an understanding of internal control over financial reporting, AU section 314 and applicable AICPA Audit and Accounting Guides provide guidance and information for the auditor.⁴

Definition of Internal Control

3.05 The definition of *internal control* in AU section 314 is based on the definition and description of internal control contained in *Internal Control—Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission. The definition is as follows:

Internal control is a process—effected by those charged with governance, management and other personnel—designed to provide reasonable assurance about the achievement of the entity's objectives in the following categories:

- Effectiveness and efficiency of operations;
- Reliability of financial reporting; and
- Compliance with applicable laws and regulations.

⁴ Because an audit of a government's financial statements under the provisions of the AICPA Audit and Accounting Guide *State and Local Governments* is based on opinion units, the auditor's consideration of internal control over financial reporting in planning, performing, evaluating the results of, and reporting on the audit of a government's basic financial statements should address each opinion unit. See that guide for further guidance.

Control Objectives

3.06 There is a direct relationship between an entity's objectives and the internal control components it implements to provide reasonable assurance about their achievement. Although the entity's objectives, and therefore controls, relate to financial reporting, operations, and compliance, not all of these objectives and controls are relevant to the audit of the financial statements. Furthermore, although internal control applies to the entire entity, an understanding of internal control relating to each of the programs or business functions may not be necessary to the performance of the audit. In general, controls that are relevant to an audit of financial statements pertain to the auditee's objective of the reliability of financial reporting and involve the preparation of financial statements for external purposes that are fairly presented in conformity with generally accepted accounting principles (GAAP) or a comprehensive basis of accounting other than GAAP,⁵ including controls that are relevant to the management of risks that may give rise to a risk of material misstatement in those financial statements. However, controls pertaining to the operations and compliance objectives may be relevant to an audit to the extent that they pertain to data the auditor may evaluate or use in applying auditing procedures to the financial statements. Controls relevant to an audit of the financial statements are referred to collectively in this guide as *internal control over financial reporting* and are encompassed in the reporting on internal control required by *Government Auditing Standards*, as discussed in chapter 4, "Auditor Reporting Requirements and Other Communication Considerations of *Government Auditing Standards*," of this guide.

Components of Internal Control

3.07 The five components of internal control are the control environment, risk assessment, information and communications, control activities and monitoring. The division of internal control into the five components provides a useful framework for auditors to consider how different aspects of an entity's internal control may affect the audit. The division does not necessarily reflect how an entity considers and implements internal control. After obtaining an understanding of each of the components, the auditor's primary consideration is whether, and how, a specific control prevents, or detects and corrects, material misstatements in relevant assertions related to classes of transactions, account balances, or disclosure, rather than its classification into a particular component. In audits of financial statements conducted in accordance with *Government Auditing Standards*, this understanding incorporates knowledge about the design of controls relevant to compliance with laws and regulations that have a direct and material effect on the determination of financial statement amounts, as well as knowledge about whether they have been placed in operation.

⁵ AU section 623, *Special Reports* (AICPA, *Professional Standards*, vol. 1), defines the comprehensive bases of accounting other than GAAS, known as *other comprehensive bases of accounting* (OCBOA), and establishes requirements for reporting on audits of OCBOA financial statements. Interpretation No. 14, "Evaluating the Adequacy of Disclosure and Presentation in Financial Statements Prepared in Conformity With an Other Comprehensive Basis of Accounting (OCBOA)," of AU section 623 (AICPA, *Professional Standards*, vol. 1, AU sec. 9623 par. .90–.95), provide additional guidance on reporting on audits of OCBOA financial statements. The AICPA Audit and Accounting Guide *State and Local Governments* discusses the application of this guidance to state and local governmental financial statements. That guide and paragraph .95 of Interpretation No. 14 also provide illustrative auditor's reports on OCBOA financial statements. In addition, in the AICPA's Practice Aid Series, two publications—*Applying OCBOA in State and Local Governmental Financial Statements* and *Preparing and Reporting on Cash- and Tax-Basis Financial Statements*—provide nonauthoritative guidance on preparing and reporting on OCBOA financial statements.

Understanding Internal Control

3.08 The auditor should obtain an understanding of the five components of internal control (listed in paragraph 3.07) sufficient to assess the risks of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures. The auditor should obtain a sufficient understanding by performing risk assessment procedures to evaluate the design of controls relevant to an audit of financial statements and to determine whether they have been implemented. The auditor should use the understanding of internal control to

- identify types of potential misstatements;
- consider factors that affect the risks of material misstatement; and
- design tests of controls, when applicable, and substantive procedures.

The difference between obtaining an understanding of controls and testing the operating effectiveness of controls is important to note. The objective of obtaining an understanding of control is to evaluate the design of controls and determine whether they have been implemented for the purpose of assessing the risks of material misstatement. In contrast, the objective of testing the operating effectiveness of controls is to determine whether the controls, as designed, prevent or detect a material misstatement. (Appendix I section A.04 of *Government Auditing Standards* contains examples of deficiencies in internal control.)

Documentation Requirements

3.09 Paragraph .122 of AU section 314 states that the auditor should document a number of items related to its understanding of the entity's environment, internal control and risk assessment. Among the matters that should be documented are the key elements of the understanding obtained regarding each of the aspects of the entity and its environment (as identified in paragraph 3.03), including each of the components of internal control identified (see paragraph 3.07), to assess the risks of material misstatement of the financial statements, the sources of information from which the understanding was obtained and the risk assessment procedures. The form and extent of this documentation is influenced by the size and complexity of the auditee, as well as by the nature of the auditee's internal control. (Chapter 2 of this guide discusses the guidance regarding audit documentation as found in AU section 339, *Audit Documentation* [AICPA, *Professional Standards*, vol. 1] and *Government Auditing Standards*. See also AU section 314 for more detail on the documentation related to its understanding of the entity's environment, internal control and risk assessment.)

Communication Requirements

3.10 AU section 325, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1), establishes requirements and provides extensive guidance about communicating matters related to an entity's internal control over financial reporting identified while performing an audit of financial statements. There are few differences between the requirements of AU section 325 and *Government Auditing Standards* relating to the communication of internal control related matters identified during an audit. (See paragraph 3.11 for additional *Government Auditing Standards*

requirements.⁶ Written communication and the use of the terminology found in AU section 325 (deficiency in internal control, significant deficiency, and material weakness) for items that need to be identified are found in both GAAS and *Government Auditing Standards*. See chapter 4 of this guide for further discussion of the *Government Auditing Standards* requirement that the internal control communication be included in a written report. (See also paragraph 3.12.) Chapter 4 further discusses the reporting and communication requirements related to internal control over financial reporting and also provides illustrative auditor's reports. AU section 325 also provides information on identifying, evaluating, and reporting on matters that relate to an entity's internal control over financial reporting identified during an audit of financial statements.

Additional *Government Auditing Standards* Requirements

3.11 As discussed in chapter 2 of this guide, *Government Auditing Standards* provides certain additional fieldwork standards that may specifically affect the auditor's consideration of internal control over financial reporting as follows:

- *Government Auditing Standards* paragraph 4.06 broadens the parties included in the communication made during the planning of the audit and adds items to be communicated. *Government Auditing Standards* states that the auditor should communicate information regarding the nature of the planned work and the level of assurance to be provided related to internal control over financial reporting and compliance with laws, regulations, and provisions of contracts or grant agreements. Also, any potential restrictions on the auditor's report should be communicated. These items should be communicated to management, those charged with governance, and the individuals contracting for or requesting the audit.
- *Government Auditing Standards* paragraph 4.09 states that auditors should evaluate whether the audited entity has taken appropriate corrective action to address findings and recommendations from previous engagements that could have a material effect on the financial statements. This information should be used in assessing risk and determining the nature, timing and extent of current audit work, including the extent to which testing the implementation of the corrective actions is applicable to the current audit objectives.

3.12 *Government Auditing Standards* states that when providing an opinion or a disclaimer on financial statements, auditors must also report on internal control over financial reporting and on compliance with laws, regulations, and provisions of contracts or grant agreements. Paragraph 5.08 of *Government Auditing Standards* states that auditors should include either in the same or

⁶ The U.S. Government Accountability Office (GAO) has issued guidance on their website at www.gao.gov/govaud/ybk01.htm that recognizes that the use of Public Company Accounting Oversight Board (PCAOB) framework for assessing deficiencies in internal control could result in inconsistencies in reporting deficiencies in internal control under *Government Auditing Standards*. The GAO guidance facilitates the reporting of deficiencies in internal control identified during audits conducted under both PCAOB and *Government Auditing Standards* to ensure the consistency of information included in the *Government Auditing Standards* report on internal control and to assist auditors in complying with *Government Auditing Standards*. (See also footnote 5 in paragraph 2.07.)

in separate report(s) a description of the scope of the auditor's testing of internal control over financial reporting and compliance with laws, regulations, and provisions of contracts or grant agreements. If separate reports are issued, the auditor should include reference to the separate report in the report on financial statements. Auditors should state in the report whether the tests performed provided sufficient, appropriate evidence to support the opinion on the effectiveness of internal control over financial reporting and on compliance with laws, regulations, and provisions of contracts or grant agreements.⁷ As discussed in chapter 4, this guide recommends a separate report on internal control over financial reporting and on compliance and other matters, which is referred to in this guide as the "Report on Internal Control over Financial Reporting and on Compliance and Other Matters."

Consideration of Financial Statement Misstatements, Including Compliance

3.13 The following paragraphs summarize the requirements of GAAS that are applicable to the auditor's consideration of financial statement misstatements, including misstatements relating to compliance,⁸ in a financial statement audit. They also discuss the additional requirements of *Government Auditing Standards*. There are unique environmental characteristics relating to compliance requirements of certain entities that are subject to audits in accordance with *Government Auditing Standards*. Federal, state, and local governments and not-for-profit entities differ from commercial enterprises in that they may be subject to numerous, diverse compliance requirements. Other entities that are subject to *Government Auditing Standards* also may have transactions and balances that involve such compliance requirements. Management is responsible for ensuring compliance with relevant laws and regulations. That responsibility encompasses the identification of applicable laws and regulations and the establishment of internal control designed to provide reasonable assurance that the auditee complies with those laws and regulations.

GAAS Requirements

General Guidance

3.14 The auditor has a responsibility to plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatements, whether caused by error or fraud.⁹ AU section 317, *Illegal Acts by Clients* (AICPA, *Professional Standards*, vol. 1), describes the auditor's responsibility in a GAAS audit for considering laws and regulations and how they affect the financial statement audit. AU section 316, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1), and

⁷ *Government Auditing Standards* permits but does not require an opinion on internal control over financial reporting if sufficient work was performed.

⁸ This guide sometimes collectively refers to laws, regulations, and provisions of contracts and grant agreements as *compliance requirements* and to illegal acts and violations of provisions of contracts or grant agreements as *noncompliance* or *instances of noncompliance*.

⁹ Because an audit of a government's financial statements under the provisions of the AICPA Audit and Accounting Guide *State and Local Governments* is based on opinion units, the auditor's consideration of financial statement misstatements due to violations of laws and regulations (including violations of provisions of contracts and grant agreements, fraud, or error in planning, performing, evaluating the results of, and reporting on the audit of a government's basic financial statements should address each opinion unit. See that guide for further guidance.

AU section 312, *Audit Risk and Materiality in Conducting an Audit* (AICPA, *Professional Standards*, vol. 1), describe the auditor's responsibility in a GAAS audit for the consideration of fraud and errors. The rest of this section describes the requirements of AU sections 317, 316, and 312.

Requirements Concerning Compliance

3.15 AU section 317 states that the auditor should design the audit to provide reasonable assurance that the financial statements are free of material misstatements resulting from illegal acts (that is, violations of laws and regulations) that have a direct and material effect on the determination of financial statement amounts. This involves identifying laws and regulations that may have a direct and material effect on the determination of financial statement amounts, and then assessing the risk that noncompliance with these laws and regulations may cause the financial statements to contain a material misstatement. The auditor considers such laws or regulations from the perspective of their known relation to audit objectives derived from financial statement assertions rather than from the perspective of legality per se.

3.16 It generally has been interpreted under GAAS that the term *laws and regulations* in AU section 317 implicitly includes provisions of contracts or grant agreements. This guide sometimes collectively refers to laws, regulations, and provisions of contracts and grant agreements as *compliance requirements* and to illegal acts and violations of provisions of contracts and grant agreements as *noncompliance* or *instances of noncompliance*.

3.17 In considering whether the financial statements may be materially misstated because of instances of noncompliance, the auditor should

- assess whether management has identified compliance requirements that have a direct and material effect on the determination of amounts in the financial statements;
- obtain an understanding of the possible effects of these compliance requirements on the determination of financial statement amounts;
- assess the risk that a material misstatement of the financial statements has occurred because of instances of noncompliance; and
- design and conduct the audit to provide reasonable assurance of detecting such material noncompliance.

3.18 The auditor may consider performing the following procedures in assessing management's identification of these compliance requirements and in obtaining an understanding of their possible effects on the determination of financial statement amounts:

- a. Consider knowledge about these compliance requirements that has been obtained from prior years' audits.
- b. Discuss these compliance requirements with the auditee's chief financial officer, legal counsel, or grant administrators.
- c. Obtain written representation from management regarding the completeness of management's identification of compliance requirements (see paragraph 3.36).
- d. Review the relevant portions of any directly related agreements, such as those related to grants and debt agreements.

- e. Obtain an understanding from management of the sources of revenue, review any related agreements (for example, debt agreements or grant agreements), and inquire about the applicability of any overall governmental regulations to the accounting for the revenue.
- f. Obtain publications pertaining to compliance requirements. Such publications include those that address federal tax and other reporting requirements, such as the Department of the Treasury and the IRS requirements pertaining to information returns and regulations concerning the calculation of arbitrage rebates and refunds.
- g. Obtain copies of, and review pertinent sections of, laws and regulations—including federal and state constitutions, articles of incorporation, charters, and bylaws—concerning the auditee. The sections of these documents pertaining, as applicable, to financial reporting, investments, debt, taxation, budget, and appropriation and procurement matters may be especially relevant.
- h. Review the minutes of meetings of the governing body of the auditee for the enactment of laws and regulations or information about contracts and grant agreements that have a direct and material effect on the determination of financial statement amounts.
- i. Inquire of the office of the federal, state, or local auditor or other appropriate audit oversight organization about the compliance requirements applicable to entities within their jurisdiction, including statutes and uniform reporting requirements.
- j. Review information about applicable federal and state program compliance requirements, such as the information included in the Office of Management and Budget *OMB Circular A-133 Compliance Supplement*,^{*} the *Catalog of Federal Domestic Assistance*, federal audit guides, and state and local policies and procedures.
- k. Review the guidance contained in the applicable AICPA Audit and Accounting Guides and the materials available from other professional organizations, such as state societies of CPAs or industry associations.
- l. Inquire of finance personnel or program administrators from which the auditee receives grants about the restrictions, limitations, terms, and conditions under which such grants were provided. Those administrators usually can be helpful in identifying compliance requirements, which they may identify separately or publish in an audit guide.

3.19 In obtaining an understanding of the possible effects on financial statements of compliance requirements that are generally recognized by auditors to have a direct and material effect on the determination of financial statement amounts, the auditor might consider

^{*} Additional guidance related to the expenditure of American Recovery and Reinvestment Act of 2009 (ARRA) funds can be found in the 2010 Office of Management and Budget *OMB Circular A-133 Compliance Supplement* and any subsequently issued addendums. Chapters in part II of this guide contain important information related to the ARRA when performing an OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133), compliance audit. See the section titled "American Recovery and Reinvestment Act Considerations" found at the end of each chapter in part II of this guide.

- the materiality of the effect on financial statement amounts, in both quantitative and qualitative terms;
- the likelihood that noncompliance may occur;
- the level of management or employee involvement in the compliance-assurance process; and
- the opportunity for concealment of instances of noncompliance.

3.20 To summarize, as part of assessing the risks of material misstatement, the auditor should assess the risk that instances of noncompliance may cause such a material misstatement. Based on that assessment, the auditor should design the audit to provide reasonable assurance of detecting instances of noncompliance that are material to the financial statements. Therefore, the auditor should design the audit to provide reasonable assurance that the financial statements are free of material misstatements resulting from instances of noncompliance that have a direct and material effect on the determination of financial statement amounts.

3.21 Auditees may be affected by many other laws and regulations, including those related to occupational safety and health, environmental protection, equal employment, food and drug administration, and price fixing or other antitrust violations. Those laws and regulations generally concern an auditee's operations more than financial reporting and accounting. Their effect on an auditee's financial statements is indirect and normally takes the form of the disclosure of a contingent liability that follows from the allegation or determination of illegality. The auditor ordinarily does not have a sufficient basis to recognize possible violations of these laws and regulations. Even when violations of such laws and regulations can have consequences that are material to the financial statements, the auditor may not become aware of the existence of the illegal act unless he or she is informed by the auditee, or unless there is evidence of an investigation or enforcement proceeding in the records, documents, or other information normally inspected in an audit of financial statements.¹⁰

3.22 If specific information comes to the auditor's attention that provides evidence concerning the existence of possible instances of noncompliance that could have a material indirect effect on the financial statements, the auditor should apply audit procedures specifically directed to ascertaining whether an instance of noncompliance occurred. However, because of the characteristics of such noncompliance, an audit conducted in accordance with GAAS provides no assurance that the indirect effect of instances of noncompliance will be detected or that any contingent liabilities that may result will be disclosed.

AU Section 316 Requirements Concerning Fraud

3.23 AU section 110, *Responsibilities and Functions of the Independent Auditor* (AICPA, *Professional Standards*, vol. 1), states that the auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether

¹⁰ In addition, for compliance with laws and regulations that have an indirect effect on the determination of financial statement amounts, AU section 317, *Illegal Acts by Clients* (AICPA, *Professional Standards*, vol. 1), notes that, where applicable, the auditor should inquire of management concerning (a) the auditee's policies relative to the prevention of illegal acts and (b) the use of directives issued by the auditee and periodic representations obtained by the auditee from management at appropriate levels of authority, concerning compliance with laws and regulations.

caused by error or fraud. AU section 316 provides guidance to auditors in fulfilling that responsibility, as it relates to fraud, in an audit of financial statements conducted in accordance with GAAS. A unique aspect of the guidance related to fraud is that whenever the auditor has determined that there is evidence that fraud exists, that matter should be brought to the attention of an appropriate level of management, even if the matter is considered inconsequential.

3.24 Although fraud is a broad legal concept, the auditor's interest specifically relates to fraudulent acts that result in a material misstatement of the financial statements. The primary factor that distinguishes fraud from error is whether the underlying action that results in the misstatement of financial statements is intentional or unintentional. Two types of misstatements are relevant to the auditor's consideration of fraud in a financial statement audit: misstatements arising from fraudulent financial reporting and misstatements arising from the misappropriation of assets. Three conditions generally are present when fraud occurs. First, management or other employees have an *incentive* or are under *pressure*, which provides a reason to commit fraud. Second, circumstances exist—for example, the absence of controls, ineffective controls, or the ability of management to override controls—that provide an *opportunity* for a fraud to be perpetrated. Third, those involved are able to *rationalize* committing a fraudulent act. Paragraphs .05–.12 of AU section 316 further discuss the two types of misstatements, the three conditions, as well as other characteristics of fraud.

3.25 The risks of material misstatement of the financial statements due to fraud is part of audit risk. AU section 316 states that, as part of planning the audit, there should be a discussion among the audit team members to consider how and where the entity's financial statements might be susceptible to material misstatement due to fraud and to reinforce the importance of adopting an appropriate mindset of professional skepticism. The auditor also should specifically do the following:¹¹

- Obtain the information needed to identify the risks of material misstatement due to fraud, which includes making inquiries of management and others within the entity, considering the results of analytical procedures performed in planning, and considering fraud risk factors and other information that might be helpful in identifying risks (see paragraphs .19–.34 of AU section 316).
- Identify the risks that may result in a material misstatement due to fraud by considering the information gathered in the previous bullet and the risk of management override of controls (paragraphs .35–.42 of AU section 316).
- Assess the identified risks after taking into account an evaluation of the entity's programs and controls that address the risks (paragraphs .43–.45 of AU section 316).
- Respond to the assessments of the risks of material misstatement due to fraud by, among other things, modifying the nature, timing,

¹¹ When the auditor is considering risk factors and other information that may be helpful in identifying risks of material misstatement due to fraud in an audit of financial statements of an entity that receives federal awards, the auditor's responsibilities under AU section 316, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1), include the consideration of risk factors associated with the receipt of federal awards that could present a material misstatement of the financial statements. This is especially true in audits conducted in accordance with Circular A-133.

and extent of auditing procedures to address the identified risks (paragraphs .46–.56 of AU section 316).

- Address the risk of management override of controls by performing procedures that include examining journal entries and other adjustments, reviewing accounting estimates for biases, and evaluating the business rationale for significant unusual transactions (paragraphs .57–.67 of AU section 316).

Because of the characteristics of fraud, the auditor's exercise of professional skepticism is important when considering the risks of material misstatement due to fraud. In addition, the auditor's assessment of the risks of material misstatement due to fraud should be ongoing throughout the audit.

3.26 Appendix I section A.07 and A.08 of *Government Auditing Standards* contains information related to indicators of fraud risk. Applicable AICPA Audit and Accounting Guides, such as *Health Care Entities*, *Not-for-Profit Entities*, and *State and Local Governments* provide additional industry-specific guidance on fulfilling the requirements of AU section 316.

3.27 Paragraph .83 of AU section 316 provides a list of the items and events that the auditor should document regarding their consideration of fraud. Among other things, the auditor should document the discussion among engagement personnel in planning the audit regarding the susceptibility of the entity's financial statements to material misstatement due to fraud, procedures performed to obtain information necessary to identify and assess the risks of material misstatement due to fraud, the specific risks of material misstatement due to fraud that were identified, and a description of the auditor's response to those risks.

3.28 AU section 316 also addresses the evaluation of audit evidence and communications about possible fraud to management, those charged with governance, and others. Refer to paragraphs .68–.82 of AU section 316 for more information. Chapter 4 of this guide discusses the auditor's responsibilities under AU section 316 for communications about fraud.

Requirements Concerning Errors

3.29 AU section 312 provides guidance to auditors in fulfilling the responsibility described in paragraph 3.23, as it relates to errors, in an audit of financial statements conducted in accordance with GAAS. Errors are described as unintentional misstatements, or as omissions of amounts or disclosures, in financial statements. Errors may involve (a) mistakes in gathering or processing data from which financial statements are prepared, (b) unreasonable accounting estimates arising from oversight or the misinterpretation of facts, and (c) mistakes in the application of accounting principles relating to amounts, classification, the manner of presentation, or disclosure. When the auditor is considering his or her responsibility to obtain reasonable assurance that the financial statements are free of material misstatement, there is no important distinction between error and fraud. There is a distinction, however, in the auditor's response to detected misstatements. An isolated, immaterial error in processing accounting data or in applying accounting principles generally is not significant to the audit. In contrast, when the auditor encounters evidence of potential fraud, regardless of its materiality, the auditor should consider its implications for the integrity of management or employees and its possible effect on other aspects of the audit. (See AU section 312 for more detailed guidance.)

Audit Documentation

3.30 The auditor should document the procedures performed to evaluate compliance with laws and regulations (including violations of provisions of contracts and grant agreements—see paragraph 3.16 and related footnote 8 in paragraph 3.13) that have a direct and material effect on the determination of financial statement amounts in accordance with AU section 339. As discussed in paragraph 3.27, AU section 316 provides requirements and guidance on the documentation of certain items and events related to the auditor's consideration of fraud. As discussed in paragraph 3.09, AU section 314 provides requirements and guidance related to documentation of the auditor's understanding of internal control over financial reporting, including as it pertains to compliance, and the related assessment of control risk. AU section 312 states that the auditor should document a summary of uncorrected misstatements, other than those that are trivial, related to both known and likely misstatements. Also, the auditor should document his or her conclusion as to whether the uncorrected misstatements, individually or in aggregate, do or do not cause the financial statements to be materially misstated, and the basis for that conclusion. See paragraphs .69–.70 of AU section 312 for other documentation guidance related to misstatements. (Chapter 2 of this guide discusses the guidance regarding audit documentation as found in AU section 339 and *Government Auditing Standards*.)

Additional Government Auditing Standards Requirements

3.31 *Government Auditing Standards* provides certain additional fieldwork standards that may specifically affect the auditor's consideration of compliance and fraud as follows:¹²

- *Government Auditing Standards* paragraph 4.05 discusses what the auditor should communicate regarding the nature, timing, and extent of planned testing and reporting and the level of assurance on compliance with laws, regulations, and provisions of contracts or grant agreements to those charged with governance during the planning stages of an audit. This standard is based on AU section 311, *Planning and Supervision* (AICPA, *Professional Standards*, vol. 1), but broadens the parties included in the communication and the items to be communicated. (See paragraphs 2.28–.29 for a discussion of additional items to be communicated and parties to be included in the communication.)
- *Government Auditing Standards* paragraph 4.10 specifically states that the auditor should design the audit to provide reasonable assurance of detecting misstatements resulting from non-compliance with provisions of contracts or grant agreements that could have a direct and material effect on the determination of financial statement amounts or other financial data significant to the audit objectives. Guidance regarding the auditor's responsibility when abuse or potential abuse is discovered can be found in paragraph 3.33.
- *Government Auditing Standards* paragraph 4.11 states that if specific information comes to the auditors' attention that provides

¹² See also chapter 2, "Planning Considerations of *Government Auditing Standards*," of this guide for a general discussion of fieldwork standards under *Government Auditing Standards*.

evidence concerning the existence of possible violations of provisions of contracts or grant agreements that could have a material indirect effect on the financial statements, the auditors should apply audit procedures specifically directed to ascertaining whether such violations have occurred.

- *Government Auditing Standards* paragraph 4.09 discusses the auditor's responsibility to evaluate management's level of corrective action of findings and recommendations from previous audits, attestation engagements, and other studies on the risk assessment procedures used to plan the current audit.

3.32 *Government Auditing Standards* also provides certain additional reporting standards related to compliance and fraud, including the following:

- a. As discussed in paragraph 5.08 of *Government Auditing Standards*, a description of the scope of the auditor's testing of compliance with laws, regulations, and provisions of contracts or grant agreements and the results of those tests.¹³ (This information is communicated in the report on internal control over financial reporting and on compliance and other matters.)
- b. As discussed in paragraph 5.15 of *Government Auditing Standards*, instances of fraud and illegal acts that have an effect on the financial statements that is more than inconsequential,¹⁴ and violations of provisions of contracts or grant agreements that have a material effect on the determination of financial statement amounts or other financial data significant to the audit. (This information is communicated in the report on internal control over financial reporting and on compliance and other matters.)
- c. As discussed in paragraph 5.16 of *Government Auditing Standards*, violations of provisions of contracts or grant agreements or abuse detected that are less than material but more than inconsequential should be communicated in writing to officials of the audited entity.

Chapter 4 of this guide further discusses the reporting and communication requirements related to compliance and fraud. That chapter also provides illustrative auditor's reports on internal control over financial reporting and on compliance on other matters.

Consideration of Abuse

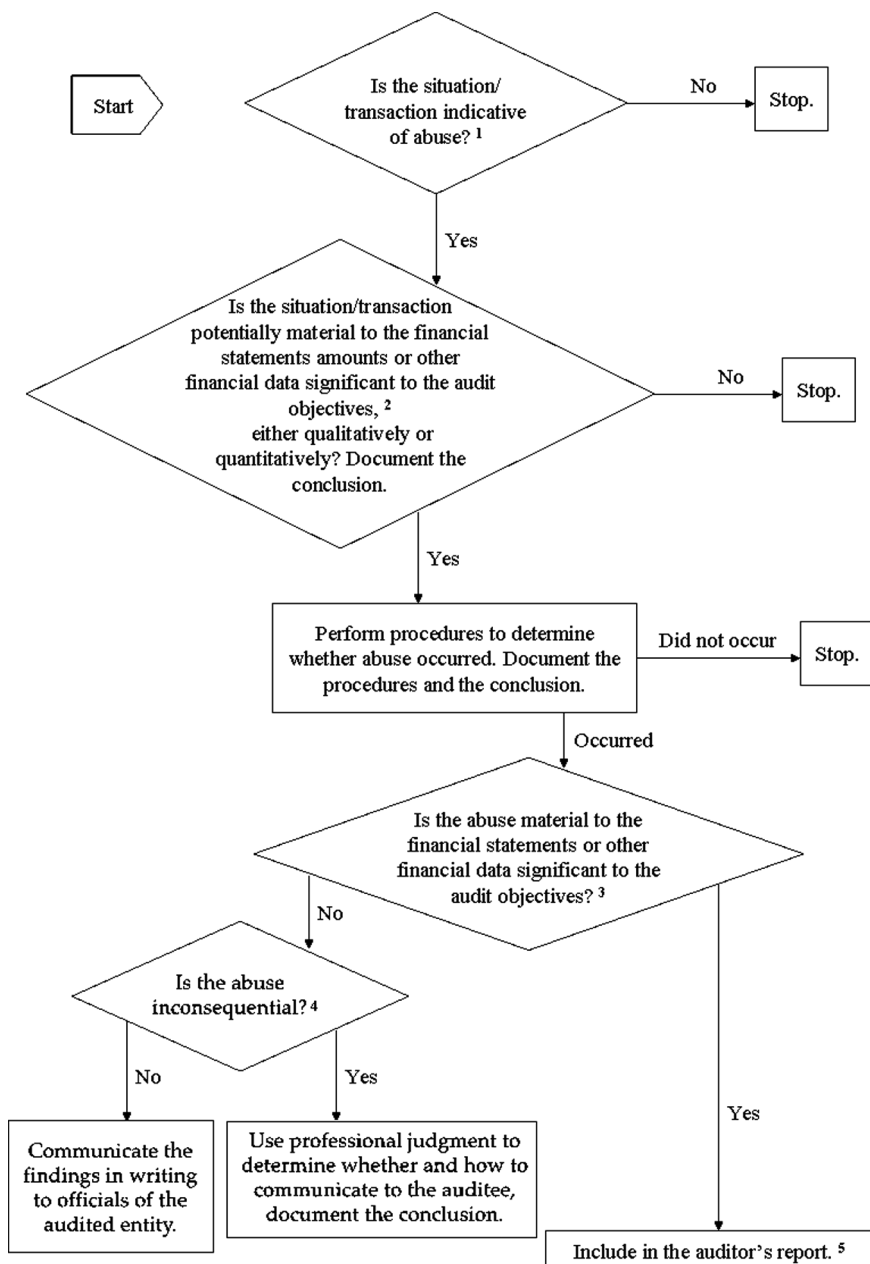
3.33 Paragraphs 4.12–13 of *Government Auditing Standards* contain an additional fieldwork standard relating to the auditor's responsibility concerning abuse. Auditors have no responsibility to design the audit to detect abuse under either GAAS or *Government Auditing Standards*. However, under *Government Auditing Standards*, if auditors become aware of indications of abuse

¹³ *Government Auditing Standards* permits but does not require an opinion on compliance if sufficient work was performed.

¹⁴ In an audit in accordance with Circular A-133, the auditor should apply a financial statement materiality consideration in reporting in the *Government Auditing Standards* report fraud and illegal acts involving federal awards that are subject to Circular A-133 reporting. Because those findings already are reported in the Circular A-133 report, reporting findings that are not material to the financial statements again in the *Government Auditing Standards* report would be unnecessarily duplicative. See chapters 4 and 13, "Auditor Reporting Requirements and Other Communication Considerations in a Single Audit," of this guide.

that could be quantitatively or qualitatively material to the financial statements, they should apply audit procedures specifically directed to ascertain the potential effect on the financial statements or other financial data significant to the audit objectives.¹⁵ Paragraph 4.12 of *Government Auditing Standards* describes "abuse" by stating that it does not necessarily involve fraud, illegal acts, and violations of provisions of contracts or grant agreements. Abuse, it states, "involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances." Abuse also includes misuse of authority or position for personal financial interests or those of an immediate or close family member or business associate. Appendix I section A.06 of *Government Auditing Standards* contains examples of possible abuse. Exhibit 3-1 is a flowchart that illustrates the evaluation and reporting of possible abuse. Chapter 4 of this guide discusses the reporting standard for abuse and provides illustrative auditor's reports on internal control over financial reporting and on compliance on other matters.

¹⁵ The reference in *Government Auditing Standards* to "other financial data significant to the audit objectives" relates to auditing procedures on financial data outside of the basic financial statements. For example, it may relate to required supplementary information (RSI) and supplementary information other than RSI (known as SI). It also relates to financial audits other than the audits of financial statements, including compliance audits conducted in accordance with Circular A-133. See the discussion of the effect of this requirement on compliance audits conducted in accordance with Circular A-133 in chapters 9, "Consideration of Internal Control over Compliance for Major Programs," and 10, "Compliance Auditing Applicable to Major Programs," of this guide.

Exhibit 3-1**Evaluation and Reporting of Findings of Possible Abuse**

- ¹ Auditors have no responsibility to design the audit to detect abuse. The steps in this flowchart may be used when the auditor becomes aware of indications of abuse.
- ² Chapters 9, "Consideration of Internal Control over Compliance for Major Programs," and 10, "Compliance Auditing Applicable to Major Programs," of this guide discuss additional considerations in evaluating abuse related to federal awards in an audit conducted in accordance with Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133). Of note in those discussions is that situations or transactions involving federal awards that might otherwise appear to constitute abuse instead generally are instances of noncompliance.
- ³ Chapter 4, "Auditor Reporting Requirements and Other Communication Considerations of *Government Auditing Standards*," of this guide discusses paragraphs 5.18–.20 of *Government Auditing Standards* which states that auditors should report abuse directly to parties outside of the auditee in certain circumstances.
- ⁴ Generally, *Government Auditing Standards* instructs the auditor to evaluate findings for the purpose of communication in the management letter or other written communication based on their consequence to the financial statements or other financial data significant to the audit objectives. As discussed in chapter 13, "Auditor Reporting Requirements and Other Communication Considerations in a Single Audit," of this guide, however, in an audit in accordance with Circular A-133, the auditor should evaluate findings involving federal awards for the purpose of that communication based only on their consequence to the financial statements.
- ⁵ The auditor should report material abuse findings related to financial statement audits in the report on internal control over financial reporting and on compliance and other matters required by *Government Auditing Standards*. Chapter 4 of this guide discusses when to report those abuse findings in the internal control section of that report or instead in the section on compliance and other matters. Chapter 13 of this guide discusses the reporting of abuse findings related to federal awards in a Circular A-133 audit, including that the auditor may need to report those findings in both (a) the report on internal control over financial reporting and on compliance and other matters required by *Government Auditing Standards* and (b) the report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with Circular A-133.

3.34 If an auditor becomes aware of a situation or transaction that might constitute abuse, the auditor should perform procedures (such as making inquiries of auditee officials about the nature of and reasons for the situation or transaction) to determine whether it is indicative of abuse. Those procedures involve evaluating whether the situation or transaction meets the definition of abuse or whether it also involves fraud or illegal acts. This distinction is important because *Government Auditing Standards*¹⁶ has different reporting stan-

¹⁶ As discussed in chapters 9 and 10 of this guide, because the OMB cost principles circulars require that costs charged to federal awards be reasonable and necessary for the performance and administration of the awards, situations or transactions involving federal awards that might otherwise appear to constitute abuse instead generally are instances of noncompliance.

dards for abuse as compared to fraud and illegal acts, as discussed in chapter 4 of this guide. Those procedures also involve evaluating whether the situation or transaction involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances. This determination is subjective and auditor judgment is a factor. If the auditor concludes that a situation or transaction is indicative of abuse, the auditor should evaluate whether it is potentially material to the financial statement amounts¹⁷ or other financial data significant to the audit objectives. If the situation or transaction is potentially material, the auditor should perform additional procedures (such as extending sample sizes by selectively choosing items for testwork). Auditors should evaluate whether a situation or transaction that constitutes abuse is material to financial statement amounts or other financial data significant to the audit objectives based on both quantitative factors and qualitative factors. Qualitative factors that the auditor may consider relevant to that evaluation include the following:

- Whether the abuse is the result of a significant deficiency in internal control
- The potential effect of the abuse on the entity's ability to raise resources (for example, through taxes, grants, contributions, or debt or loan financings) in the future
- The potential effect of the abuse on the continuation of existing relationships with vendors, employees, and elected and appointed officials
- Whether the abuse involves collusion or concealment
- Whether the abuse involves an activity that often is scrutinized by elected or appointed officials, citizens, the press, creditors, or rating agencies
- Whether the fact of the abuse is unambiguous rather than a matter of judgment
- Whether the abuse is an isolated event or instead has occurred with some frequency
- Whether the abuse results from management's continued unwillingness to correct internal control weaknesses
- The likelihood that similar abuse will continue in the future
- The cost-benefit of establishing internal control to prevent similar abuse in the future
- The risk that possible undetected abuse would affect the auditor's evaluation

3.35 As indicated in exhibit 3-1, *Government Auditing Standards* provides guidance for reporting immaterial abuse outside of the auditor's report. Given the process for categorizing a situation or transaction as constituting abuse, and given that abuse often is material based on qualitative rather than quantitative factors, findings of abuse generally would be material or at least consequential.

¹⁷ Because an audit of a government's financial statements under the provisions of the AICPA Audit and Accounting Guide *State and Local Governments* is based on opinion units, the auditor's consideration of abuse in planning, performing, evaluating the results of, and reporting on the audit of a government's basic financial statements should address each opinion unit. See that guide for further guidance.

However, an auditor might conclude that identified abuse is inconsequential. For example, the auditor might find an isolated instance of abuse at an entity that subsequently instituted controls to prevent future, similar abuse. See chapter 4 for further discussion of reporting or otherwise communicating instances of abuse.

Written Representations From Management

3.36 AU section 333, *Management Representations* (AICPA, *Professional Standards*, vol. 1), states that the auditor should obtain written representations from management as part of an audit conducted in accordance with GAAS. It also includes an illustrative management representation letter and an appendix containing additional representations that may be appropriate to be included in a management representation letter in certain circumstances. With respect to a financial statement audit conducted in accordance with GAAS and *Government Auditing Standards*, representations ordinarily should be tailored to include additional appropriate representations from management relating to matters specific to the entity's business or industry. For example, it may be appropriate to obtain additional representations from management acknowledging that management¹⁸

- a. is responsible for compliance with the laws, regulations, and provisions of contracts and grant agreements applicable to the auditee.
- b. is responsible for establishing and maintaining effective internal control over financial reporting.
- c. has identified and disclosed to the auditor all laws, regulations, and provisions of contracts and grant agreements that have a direct and material effect on the determination of financial statement amounts or other financial data significant to the audit objectives.
- d. has identified and disclosed to the auditor violations (and possible violations) of laws, regulations, and provisions of contracts and grant agreements whose effects should be considered for disclosure in the financial statements, as a basis for recording a loss contingency, or for auditor reporting on noncompliance.
- e. has reviewed, approved, and taken responsibility for the financial statements and related notes and an acknowledgment of the auditor's role in the preparation of this information. (This representation is one that should be made as noted in paragraph 3.28a of *Government Auditing Standards* when the auditor has a role in preparing the trial balance and draft financial statements and related notes.)
- f. has taken timely and appropriate steps to remedy fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse that the auditor reports.
- g. has a process to track the status of audit findings and recommendations.
- h. has identified for the auditor previous audits, attestation engagements, and other studies related to the audit objectives and whether related recommendations have been implemented.

¹⁸ The auditor may modify these representations, as appropriate, for different conditions, such as if management does not have a process to track the status of audit findings and recommendations.

- i. has provided views on the auditors' reported findings, conclusions, and recommendations, as well as management's planned corrective actions, for the report.

An auditor should obtain representations from those members of management with overall responsibility for financial and operating matters that the auditor believes are responsible for and knowledgeable about, directly or through others in the organization, the matters covered by the representations. Such members of management normally include the chief executive officer and chief financial officer or others in equivalent positions (such as the management of component organizations). It often is desirable to obtain representation letters from other officials (for example, asking the recording secretary for the governing body to represent that the minutes are complete for all meetings held during the period and through the date of the auditor's report). The written representations should be dated as of the date of the auditor's report. This is to ensure that the auditor's report is not dated prior to the date on which the auditor has obtained sufficient appropriate audit evidence (paragraph .23 of AU section 339).

Reasonable Assurance

3.37 AU section 230, *Due Professional Care in the Performance of Work* (AICPA, *Professional Standards*, vol. 1), states that the high, but not absolute, level of assurance that is intended to be obtained by the auditor is expressed in the auditors report as obtaining reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Absolute assurance is not attainable because of the nature of audit evidence and the characteristics of fraud. Therefore, an audit conducted in accordance with GAAS may not detect a material misstatement. It also states that because the auditor's opinion on the financial statements is based on the concept of obtaining reasonable assurance, the auditor is not an insurer and his or her audit report does not constitute a guarantee. Therefore, the subsequent discovery that a material misstatement, whether from error or fraud, exists in the financial statements does not, in and of itself, evidence (a) failure to obtain reasonable assurance, (b) inadequate planning, performance, or judgment, (c) the absence of due professional care, or (d) a failure to comply with GAAS. Paragraph 3.39 of *Government Auditing Standards* similarly states in part that "while this standard places responsibility on each auditor and audit organization to exercise professional judgment in planning and performing an audit or attestation engagement, it does not imply unlimited responsibility, nor does it imply infallibility on the part of either the individual auditor or the audit organization." Further, paragraph 4.13 of *Government Auditing Standards* states that the determination of abuse is subjective and that auditors are not required to provide reasonable assurance of detecting abuse.

Chapter 4

Auditor Reporting Requirements and Other Communication Considerations of Government Auditing Standards

Overview

4.01 This chapter discusses the auditor's reporting requirements and other communication considerations in an audit of financial statements conducted in accordance with *Government Auditing Standards*. (Appendix A [paragraph 4.51] presents illustrative auditor's reports for those audits.) Primary among the reporting requirements are that the auditor (a) express an opinion or disclaim an opinion on the financial statements¹ and (b) report on internal control over financial reporting and on compliance and other matters.

Government Auditing Standards—Reporting Requirements

Generally Accepted Auditing Standards Requirements

4.02 Generally accepted auditing standards (GAAS) contain 4 reporting standards, all of which are incorporated into *Government Auditing Standards*.² The 4 standards, as found in paragraph .02 of AU section 150, *Generally Accepted Auditing Standards* (AICPA, *Professional Standards*, vol. 1) (see also paragraph 5.03 of *Government Auditing Standards*), follow:

- The auditor must state in the auditor's report whether the financial statements are presented in accordance with generally accepted accounting principles (GAAP).
- The auditor must identify in the auditor's report those circumstances in which such principles have not been consistently observed in the current period in relation to the preceding period.
- When the auditor determines that informative disclosures are not reasonably adequate, the auditor must so state in the auditor's report.

¹ As explained in the AICPA Audit and Accounting Guide *State and Local Governments*, the auditor generally expresses or disclaims an opinion on a government's basic financial statements by providing an opinion or disclaimer of opinion on each opinion unit required to be presented in those financial statements. In addition, the auditor may provide opinions or disclaimers of opinions on additional opinion units if engaged to set the scope of the audit and assess materiality at a more detailed level than by the opinion units required for the basic financial statements. Throughout this guide, the use of the singular terms *opinion* and *disclaimer of opinion* encompasses the multiple opinions and disclaimers of opinion that generally will be provided on a government's financial statements.

² *Government Auditing Standards* incorporates the fieldwork and reporting standards of generally accepted auditing standards (GAAS) and the related Statements on Auditing Standards (SASs) issued by the AICPA unless the Comptroller General of the United States excludes them by formal announcement. To date, the Comptroller General has not excluded any fieldwork or reporting standards or related SASs.

- The auditor must either express an opinion regarding the financial statements, taken as a whole, or state that an opinion cannot be expressed in the auditor's report. When the auditor cannot express an overall opinion, the auditor should state the reasons therefore in the auditor's report. In all cases in which an auditor's name is associated with financial statements, the auditor should clearly indicate the character of the auditor's work, if any, and the degree of responsibility the auditor is taking in the auditor's report.

4.03 AU section 508, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1), establishes requirements for reporting on audits of financial statements that are intended to be presented in conformity with GAAP. AU section 623, *Special Reports* (AICPA, *Professional Standards*, vol. 1), establishes requirements for reporting on audits of financial statements that are prepared in conformity with a comprehensive basis of accounting other than GAAP, known as *other comprehensive bases of accounting*.³ AU section 550A,^{*} *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1); AU section 551A,[†] *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents* (AICPA, *Professional Standards*, vol. 1); and AU section 558A,[‡] *Required Supplementary Information* (AICPA, *Professional Standards*, vol. 1),

³ Interpretation No. 14, "Evaluating the Adequacy of Disclosure and Presentation in Financial Statements Prepared in Conformity With an Other Comprehensive Basis of Accounting (OCBOA)," and Interpretation No. 15, "Auditor Reports on Regulatory Accounting or Presentation When the Regulated Entity Distributes the Financial Statements to Parties Other Than the Regulatory Agency Either Voluntarily or Upon Specific Request," of AU section 623, *Special Reports* (AICPA, *Professional Standards*, vol. 1, AU sec. 9623 par. .90–.98), provide additional guidance on reporting on audits of financial statements that are prepared in conformity with a comprehensive basis of accounting other than generally accepted accounting principles (GAAP), known as *other comprehensive bases of accounting*, or OCBOA. The AICPA Audit and Accounting Guide *State and Local Governments* discusses the application of AU section 623 and Interpretation Nos. 14–15 of AU section 623 to state and local governmental financial statements. That guide and paragraph .97 of Interpretation No. 15 also provide illustrative auditor's reports on OCBOA financial statements. In addition, in the AICPA's Practice Aid Series, two publications—*Applying OCBOA in State and Local Governmental Financial Statements* and *Preparing and Reporting on Cash- and Tax-Basis Financial Statements*—provide nonauthoritative guidance on preparing and reporting on financial statements prepared in conformity with OCBOA.

^{*} SAS No. 118, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 550), was issued in February 2010. This SAS addresses and clarifies the auditor's responsibility in relation to other information in documents containing audited financial statements and the auditor's report thereon. The SAS is effective for audits of financial statements for periods beginning on or after December 15, 2010. Early implementation is permitted. Upon its effective date, SAS No. 118 will supersede the requirements and guidance in AU section 550A, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1), and, along with SAS No. 119, *Supplementary Information in Relation to the Financial Statements as a Whole* (AICPA, *Professional Standards*, vol. 1, AU sec. 551), the requirements in AU section 551A, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents* (AICPA, *Professional Standards*, vol. 1).

[†] SAS No. 119 was issued in February 2010. This SAS addresses and clarifies the auditor's responsibility when engaged to opine on whether supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole. The SAS is effective for audits of financial statements for periods beginning on or after December 15, 2010. Early implementation is permitted. Upon its effective date, SAS No. 119, along with SAS No. 118, will supersede the requirements and guidance in AU section 551A.

[‡] SAS No. 120, *Required Supplementary Information* (AICPA, *Professional Standards*, vol. 1, AU sec. 558), was issued in February 2010. This SAS addresses and clarifies the auditor's responsibility in relation to information supplementary to the basic financial statements when that is required by a designed accounting standard setter to accompany such financial statements. The SAS is effective for audits of financial statements for periods beginning on or after December 15, 2010. Early implementation is permitted. Upon its effective date, SAS No. 120 will supersede the requirements and guidance in AU section 558A, *Required Supplementary Information* (AICPA, *Professional Standards*, vol. 1).

provide guidance on reporting on additional information that accompanies the basic financial statements—both required supplementary information (RSI) and supplementary information other than RSI, known as SI.⁴ Auditors also may refer to applicable AICPA Audit and Accounting Guides, such as *Health Care Entities*, *Not-for-Profit Entities*, and *State and Local Governments*, for additional guidance on reporting on the financial statements of specific industries.

Government Auditing Standards—Additional Reporting Standards^{||}

4.04 *Government Auditing Standards* requires that in addition to providing an opinion or a disclaimer of opinion on the financial statements, the auditor must report on internal control over financial reporting and compliance with laws, regulations, and provisions of contracts or grant agreements.⁵ The auditor also should report certain fraud and abuse.

4.05 *Government Auditing Standards* contains the following 8 reporting standards in addition to the AICPA standards listed in paragraph 4.02:

- a. When the report on the financial statements is submitted to comply with a requirement for an audit in accordance with *Government Auditing Standards*, or when those standards are voluntarily followed, the report should state that the audit was performed in accordance with generally accepted government auditing standards. When citing compliance with *Government Auditing Standards*, the auditor should include either an unmodified compliance statement or a modified compliance statement, as appropriate. (See paragraphs 5.05–.06 of *Government Auditing Standards*.) Paragraphs 4.24–.25 discuss this requirement.
- b. When providing an opinion or a disclaimer on financial statements, auditors must also report on internal control over financial reporting and on compliance with laws, regulations, and provisions of contracts or grant agreements. In the same or in separate report(s),

⁴ The Audit and Accounting Guide *State and Local Governments* includes flowcharts that summarize auditor procedures and reporting on required supplementary information (RSI) and supplementary information other than RSI.

^{||} *Government Auditing Standards*, July 2007 Revision, contains guidance on reporting deficiencies in internal control based on SAS No. 112, *Communicating Internal Control Related Matters Identified in an Audit*, which has been superseded by SAS No. 115, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 325). U.S. Government Accountability Office (GAO) plans to update *Government Auditing Standards* to reflect the revised definitions. Until GAO issues the revised standard, auditors should use the guidance issued November 2008, "Interim Guidance on Reporting Deficiencies in Internal Control for GAGAS Financial Audits and Attestation Engagements." This guidance states that auditors may satisfy the internal control reporting requirements in paragraph 5.11 of *Government Auditing Standards* by including in the report on internal control all identified material weaknesses and significant deficiencies following the definitions and requirements from SAS No. 115, providing those definitions, and describing the scope of testing performed on the entity's internal control over financial reporting. GAO's interim guidance becomes effective concurrently with the auditors' implementation of SAS No. 115. See the website at www.gao.gov/govaud/ybk01.htm for the full text of this guidance. See chapter 3, "Financial Statement Audit Considerations of *Government Auditing Standards*," of this guide for related fieldwork considerations.

⁵ *Government Auditing Standards* and AU section 317, *Illegal Acts by Clients* (AICPA, *Professional Standards*, vol. 1), define the term *illegal acts* as violations of laws and regulations. As indicated in chapter 3 of this guide, it generally has been interpreted under GAAS that the term *laws and regulations* in AU section 317 implicitly includes provisions of contracts or grant agreements. This guide sometimes collectively refers to laws, regulations, and provisions of contracts and grant agreements as *compliance requirements* and to illegal acts and violations of provisions of contracts or grant agreements as *noncompliance* or *instances of noncompliance*.

the auditors should include a description of the scope of the auditor's testing of internal control over financial reporting and compliance with laws, regulations, and provisions of contracts or grant agreements. Auditors should state in the report whether the tests performed provided sufficient, appropriate evidence to support an opinion of the effectiveness of internal control over financial reporting and on compliance with laws, regulations, and provisions of contracts or grant agreements. (See paragraph 5.08 of *Government Auditing Standards*.)⁶ When auditors report separately (including separate reports bound in the same document) on internal control over financial reporting and on compliance with laws and regulations and provisions of contracts or grant agreements, they should state in the financial statement audit report that they are issuing those additional reports. Auditors should also state that the reports on internal control over financial reporting and on compliance with laws and regulations and provisions of grant agreements are an integral part of a *Government Auditing Standards* audit and important for assessing the results of the audit. This guide recommends a separate report on internal control over financial reporting and on compliance and other matters, which is referred to in this guide as the "Report on Internal Control over Financial Reporting and on Compliance and Other Matters." This guide also recommends that the reference to the separate report indicate that the separate report does not provide an opinion on internal control over financial reporting or on compliance.⁷ See the illustrative reports in examples 4-3, 4-5, and 4-7 in appendix A (paragraph 4.51). Paragraphs 4.08–.10 and 4.27–.28 further discuss reporting on internal control over financial reporting and on compliance.

- c. For financial audits, including audits of financial statements in which auditors provide an opinion or disclaimer, auditors should report, as applicable to the objectives of the audit and based upon the audit work performed, (1) significant deficiencies in internal control,⁸ identifying those considered to be material weaknesses, (2) all instances of fraud and illegal acts unless inconsequential, and (3) violations of provisions of contracts or grant agreements and abuse that could have a material effect on the financial statements.⁹ In

⁶ Paragraph 5.08 of *Government Auditing Standards* permits, but does not require, an opinion on internal control over financial reporting or on compliance if sufficient work was performed.

⁷ This guide makes this recommendation so that report users who are accustomed to an opinion on internal control over financial reporting in auditor's reports for *issuers*, as that term is defined by the Sarbanes-Oxley Act of 2002 or whose audit is prescribed by the rules of the Securities and Exchange Commission, do not assume that the separate report provides opinions on internal control over financial reporting or compliance. If the auditor provides an opinion on internal control over financial reporting or on compliance (see footnote 6 in paragraph 4.05b), this guide recommends that the reference to the separate report be modified to indicate that there is such an opinion.

⁸ Paragraph 5.13 of *Government Auditing Standards* states that if (1) a significant deficiency is remediated before the auditors' report is issued and (2) the auditors obtain sufficient, appropriate evidence supporting the remediation of the significant deficiency, then the auditors should report the significant deficiency and the fact that it was remediated before the auditors' report was issued.

⁹ *Government Auditing Standards* requires this reporting even if the auditor disclaims an opinion on the financial statements. These findings are communicated in the report on internal control over financial reporting and on compliance and other matters. *Government Auditing Standards* also provides reporting requirements for other findings of deficiencies in internal control, fraud, illegal acts, violations of provisions of contracts or grants agreements, and abuse, as summarized in table 4-1 and discussed in paragraph 4.37.

some circumstances, auditors should report fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse directly to parties external to the audited entity. (See paragraph 5.18 of *Government Auditing Standards*.) Paragraphs 4.09, 4.16–.17, and 4.27–.28 further discuss the requirements of this standard, and paragraphs 4.29–.34 discuss the reporting of findings.

- d. Under AICPA standards, an auditor may emphasize in the auditor's report certain significant matters regarding the financial statements as found in paragraph .19 of AU section 508. *Government Auditing Standards* expands the matters that may be included in the report. Determining whether to include such information in the auditor's report is a matter of professional judgment. The communication may be put in a separate paragraph or separate section of the auditor's report and may include information that is not disclosed in the financial statements. Paragraph 5.24 of *Government Auditing Standards* discusses examples of items that may be communicated. The 4 matters listed are (1) significant concerns or uncertainties about the fiscal sustainability of a government or program or other matters that could have a significant impact on the financial condition or operation of the government entity beyond 1 year of the financial statement date (although the auditor is not responsible for designing audit procedures to detect such concerns or uncertainties, and any judgment about the future is based on information that is available at the time the judgment is made); (2) unusual or catastrophic events that will likely have a significant ongoing or future impact on the entity operations or its financial condition; (3) significant uncertainties surrounding projections or estimates in the financial statements; and (4) any other matter that the auditors consider significant for communication to users and oversight bodies.
- e. When auditors become aware of new information that could have affected their report on previously issued financial statements, paragraphs 5.26–.31 of *Government Auditing Standards* provide requirements that go beyond the AICPA requirements found in AU section 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* (AICPA, *Professional Standards*, vol. 1). In addition to AICPA requirements, *Government Auditing Standards* state that auditors should advise management to make appropriate disclosures when it is likely that previously issued financial statements are misstated and the misstatement is, or reasonably could be, material. The auditors should also perform certain procedures related to the restated financial statements as described in *Government Auditing Standards* paragraph 5.27. The auditor should evaluate the timeliness and appropriateness of management's disclosure and actions to determine and correct misstatements in previously-issued financial statements, update the auditor's report on restated financial statements, and report directly to appropriate officials when the audited entity does not take the necessary steps.
- f. If the auditors' report discloses deficiencies in internal control, fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse, auditors should obtain and report the views

of responsible officials concerning the findings, conclusions, and recommendations, as well as planned corrective actions. (See paragraphs 5.32–.38 of *Government Auditing Standards*). Paragraphs 4.35–.36 further discuss the requirements of this standard.

- g. If certain pertinent information is prohibited from public disclosure (as it may be by federal, state, or local laws or regulations) or is excluded from a report due to the confidential or sensitive nature of the information, auditors should disclose in the report that certain information has been omitted and the reason or other circumstances that make the omission necessary. (See paragraphs 5.39–.43 of *Government Auditing Standards*, which also discuss the issuance and distribution of separate classified or limited use reports containing omitted information, including information that is omitted because of public safety and security concerns.)
- h. Audit organizations in government entities should distribute audit reports to those charged with governance, the appropriate officials of the audited entity, and to appropriate oversight bodies or organizations requiring or arranging for the audits. As appropriate, they should also distribute copies of the reports to other officials who have legal oversight authority or who may be responsible for acting on audit findings and recommendations and to others authorized to receive such reports. Public accounting firms contracted to perform an audit under *Government Auditing Standards* should clarify report distribution responsibilities with the engaging organization.¹⁰ If the contracted firm is to make the distribution, it should reach agreement with the party contracting for the audit about which officials or organizations will receive the report and the steps being taken to make the report available to the public. (See paragraph 5.44 of *Government Auditing Standards*.)

4.06 Table 4-1 summarizes *Government Auditing Standards* requirements for reporting matters relating to internal control over financial reporting, fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse, as discussed in this chapter.

¹⁰ This guide recommends that auditors make the required clarification in the engagement letter or other understanding with the auditee; see chapter 2, "Planning Considerations of *Government Auditing Standards*," of this guide. In addition, auditors could make the clarification in correspondence that transmits the reports to the auditee and other recipients.

Table 4-1

**Government Auditing Standards
Requirements for Reporting Findings**

| | <i>Report on Internal Control Over Financial Reporting and on Compliance and Other Matters</i> | <i>Communicate in Writing¹</i> | <i>Auditors Use Professional Judgment to Determine Reporting</i> |
|----------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------|-----------------------------------------------|----------------------------------------------------------------------------------|
| Deficiencies in internal control over financial reporting*: | | | |
| Significant deficiencies (Those that are, either individually or in the aggregate, material weaknesses should be so identified.) | X | | |
| Other deficiencies in internal control that are not significant deficiencies or material weaknesses | | | X |
| Fraud and illegal acts: | | | |
| Those that have an effect on the financial statements that is more than inconsequential ² | X | | |
| Those that are inconsequential | | | X |
| Violations of provisions of contracts or grant agreements and abuse: | | | |
| Those that have a material effect on the financial statements or other data significant to the audit | X | | |
| Less than material but more than inconsequential | | X | |
| Those that are inconsequential | | | X |

(continued)

* See footnote 11 to the heading before paragraph 4.04.

¹ See paragraph 4.37 and footnote 35.

² As explained in paragraph 4.16, in an audit in accordance with Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133), the auditor should apply a financial statement materiality consideration in reporting in the *Government Auditing Standards* report fraud and illegal acts involving federal awards that are subject to Circular A-133 reporting.

Internal Control Over Financial Reporting ¹¹

GAAS Requirements

4.07 AU section 325, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1), provides guidance on communicating matters related to an auditee's internal control over financial reporting identified in an audit of financial statements. AU section 325 states that the auditor should communicate to management and those charged with governance, in writing, deficiencies identified during the audit that are considered to be significant deficiencies or material weaknesses. Those charged with governance are the person(s) with responsibility for overseeing the strategic direction of the entity and obligations related to accountability of the entity, including overseeing financial reporting and disclosures, such as the board of directors, the board of trustees, or an owner in an owner-managed enterprise. Other examples include governing boards, city councils, audit committees, mayors, governors, legislators, university and college presidents, and chancellors. Significant deficiencies and material weaknesses that were previously communicated and have not yet been remediated may be communicated, in writing, by referring to the previously issued written communication and the date of that communication. In addition to requiring the communication of significant deficiencies and material weaknesses in the internal control over financial reporting, AU section 325 states that because early communication of other matters may be important because of their relative significance and the urgency for corrective follow-up action, the auditor may decide to communicate certain matters orally during the course of the audit rather than waiting until after the audit is concluded. However, even in that case, the communication of any significant deficiencies and material weaknesses should also be in writing, even if such significant deficiencies or material weaknesses are remediated during the audit. Paragraph .18 of AU section 325 states that the written communication is best made by the report release date, which is the date the auditor grants the entity permission to use the auditor's report in connection with the financial statements. However, the written communication should be made no later than 60 days following the report release date. When performing

¹¹ Chapter 3 of this guide discusses the auditor's consideration of internal control over financial reporting. Because an audit of a government's financial statements under the provisions of the AICPA Audit and Accounting Guide *State and Local Governments* is based on opinion units (see footnote 1 in paragraph 4.01), the auditor's consideration of internal control over financial reporting in planning, performing, evaluating the results of, and reporting on the audit should address each opinion unit.

an audit in accordance with *Government Auditing Standards*, the issuance of the required internal control reporting described in paragraphs 4.08–.09 and 4.27–.28 meets the AU section 325 communication requirements. A separate communication to meet AU section 325 requirements is not necessary when the auditor is issuing a *Government Auditing Standards* report, "Report on Internal Control over Financial Reporting and on Compliance and Other Matters," that describes the scope of the auditor's testing of internal control over financial reporting and presents the results of those tests.

Government Auditing Standards Requirements

4.08 As discussed in paragraph 4.05*b*, paragraph 5.07 of *Government Auditing Standards* states that the auditor must issue a report on internal control over financial reporting. That report should describe the scope of the auditor's testing of internal control over financial reporting and whether the tests performed provided sufficient, appropriate audit evidence to support an opinion on the effectiveness of internal control over financial reporting. Written reporting on internal control matters under *Government Auditing Standards* is based on the auditor's consideration of the internal control over financial reporting as required by AU section 314, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AICPA, *Professional Standards*, vol. 1). See chapter 3, "Financial Statement Audit Considerations of *Government Auditing Standards*," of this guide. The report should describe the extent of the work performed under the provisions of AU section 314 and encompass the requirements of AU section 325 as well as the additional requirements of *Government Auditing Standards*. Although not required, *Government Auditing Standards* does permit the report to express an opinion on the auditee's internal control over financial reporting if sufficient work was performed.

4.09 Paragraph 5.10 of *Government Auditing Standards* states that auditors should report significant deficiencies and material weaknesses in internal control over financial reporting as defined in paragraph 5.11 of *Government Auditing Standards*.¹² Appendix I paragraph A.04 of *Government Auditing Standards* contain, examples of deficiencies in internal control, and AU section 325 also provides guidance on evaluating potential deficiencies in internal control and examples of circumstances that may be deficiencies in internal control, significant deficiencies, and material weaknesses. Paragraphs 4.29–.34 of this chapter describe *Government Auditing Standards* requirements for presenting audit findings, including deficiencies in internal control. Paragraph .25 of AU section 325 prohibits the auditor from issuing a written communication stating that no significant deficiencies were identified during an audit. The illustrative report in example 4-3 in appendix A (paragraph 4.51), provides recommended language that satisfies the requirements of *Government Auditing Standards* when no significant deficiencies were identified during an audit. The illustrative report in example 4-5 in appendix A (paragraph 4.51), provides recommended language that satisfies the requirements of *Government Auditing Standards* when significant deficiencies (whether or not they are considered to be material weaknesses) are noted during an audit. The illustrative report in example 4-7 in appendix A (paragraph 4.51), provides recommended language

¹² The definitions of *significant deficiency* and *material weakness* in paragraph 5.11 of *Government Auditing Standards* are consistent with those found in SAS No. 112, which has been superseded by SAS No. 115. However, GAO has issued guidance regarding the use of the guidance in SAS No. 115. See footnote II to the heading before paragraph 4.04 for more information.

that satisfies the requirements of Government Auditing Standards when material weaknesses and significant deficiencies are noted during an audit.

4.10 Table 4-2 summarizes the differences between AU section 325 and *Government Auditing Standards* with respect to reporting on internal control over financial reporting.

Table 4-2

Reporting on Internal Control Over Financial Reporting

| | Government Auditing Standards | AU section 325 |
|--------------------------------------------------------------------|----------------------------------------------------------|---------------------------------------------------------------------|
| How are significant deficiencies and material weaknesses reported? | In a report on internal control over financial reporting | In a communication to management and those charged with governance |
| When is reporting required? | For every financial statement audit | When significant deficiencies or material weaknesses are identified |
| What is the form of the report? | Written | Written |

Fraud, Illegal Acts, Violations of Provisions of Contracts or Grant Agreements, and Abuse¹³

GAAS Requirements

Illegal Acts, Including Violations of Provisions of Contracts or Grant Agreements

4.11 AU section 317, *Illegal Acts by Clients* (AICPA, *Professional Standards*, vol. 1), discusses the auditor's responsibilities with respect to the consideration of illegal acts and the communication with those charged with governance.¹⁴ (AU section 317 defines *illegal acts* as violations of laws or government regulations. It generally has been interpreted under GAAS that the term *laws and regulations* in AU section 317 implicitly includes provisions of contracts or grant agreements.) Paragraph .17 of AU section 317 states that the auditor should assure himself or herself that those charged with governance are adequately informed with respect to illegal acts (including violations of provisions of contracts or grant agreements) that come to the auditor's attention.

¹³ Chapter 3 of this guide discusses the auditor's consideration of fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse. Because an audit of a government's financial statements under the provisions of the AICPA Audit and Accounting Guide *State and Local Governments* is based on opinion units (see footnote 1 in paragraph 4.01), the auditor's consideration of fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse in planning, performing, evaluating the results of, and reporting on the audit should address each opinion unit.

¹⁴ Paragraph .17 of AU section 317 permits the communication to be oral or written (with audit documentation if oral), but *Government Auditing Standards* requires the communication to be in writing. See paragraphs 4.16–.21 for a discussion of the applicable *Government Auditing Standards* guidance.

The auditor need not communicate matters that are inconsequential and may reach agreement in advance with the audit committee on the nature of such matters to be communicated. The communication should describe the act, the circumstances of its occurrence, and its effect on the financial statements. If senior management is involved, the auditor should communicate directly with those charged with governance. Chapter 3 of this guide summarizes other requirements of AU section 317 as related to fieldwork. The auditor also should consider the effect of any noncompliance on the financial statements, and should modify the auditor's report on those financial statements as necessary in accordance with AU section 508.

Fraud

4.12 AU section 316, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1), discusses the auditor's responsibilities for fraud, including communications about fraud to management, those charged with governance, and others based on a financial statement audit in accordance with GAAS. Whenever the auditor has determined that there is evidence that fraud may exist, the auditor should bring that matter to the attention of an appropriate level of management. This is appropriate even if the matter might be considered inconsequential, such as a minor defalcation by an employee at a low level in the auditee's organization. The auditor should report directly to those charged with governance (a) fraud involving senior management and (b) fraud, whether caused by senior management or other employees, that causes a material misstatement of the financial statements. In addition, the auditor should reach an understanding with those charged with governance regarding the nature and extent of communications with them about misappropriations perpetrated by lower-level employees. Under GAAS, the disclosure of possible fraud to parties other than the auditee's senior management and those charged with governance ordinarily is not part of the auditor's responsibility and ordinarily would be precluded by the auditor's ethical or legal obligations of confidentiality unless the matter is reflected in the auditor's report. The auditor should recognize, however, that in the following circumstances a duty to disclose to parties outside the auditee may exist:

- To comply with certain legal and regulatory requirements
- To a successor auditor when the successor makes inquiries in accordance with AU section 315, *Communications Between Predecessor and Successor Auditors* (AICPA, *Professional Standards*, vol. 1)
- In response to a subpoena
- To a funding agency or other specified agency in accordance with the requirements for audits of entities that receive governmental financial assistance

The previously listed circumstances encompass financial audits in accordance with *Government Auditing Standards*, which establishes additional reporting requirements relating to fraud. See paragraphs 4.16–21.

4.13 If the auditor, as a result of the assessment of the risks of material misstatement, has identified risks of material misstatements due to fraud that have continuing control implications (whether or not transactions or adjustments that could be the result of fraud have been detected), the auditor should consider whether those risks represent significant deficiencies relating to the

auditee's internal control that the auditor should communicate to management and those charged with governance.¹⁵ (See paragraph 4.07.) The auditor also should consider whether the absence of or deficiencies in programs and controls to mitigate specific risks of fraud or to otherwise help prevent, deter, and detect fraud represent significant deficiencies that should be communicated to management and those charged with governance. The auditor also may wish to communicate other risks of fraud identified as a result of the assessment of the risks of material misstatements due to fraud.

4.14 Paragraphs .79–.82 of AU section 316 discuss the communication requirements related to fraud as discussed previously. Chapter 3 of this guide summarizes other requirements of AU section 316¹⁶ as they relate to fieldwork.

Abuse

4.15 GAAS does not require the reporting of abuse. *Government Auditing Standards* does require reporting about abuse; see paragraphs 4.16–.21 for a discussion of the requirements.

Government Auditing Standards Requirements

4.16 As discussed in paragraph 4.05*b*, paragraphs 5.07–.08 of *Government Auditing Standards* requires the auditor to issue a report that describes the scope of the auditor's testing of compliance with laws, regulations, and provisions of contracts or grant agreements and present the results of those tests. As discussed in paragraph 4.05*c*, paragraph 5.10 of *Government Auditing Standards* also states that the auditor should report, as applicable to the objectives of the audit, and based on the audit work performed, (1) all instances of fraud and illegal acts unless inconsequential; and (2) violations of provisions of contracts or grant agreements and abuse that could have a material effect on the financial statements. (See paragraph 4.19 for a discussion of the *Government Auditing Standards* requirement relating to reporting violations of provisions of contracts or grant agreements or abuse that have an effect on the financial statements that is less than material but more than inconsequential.) In addition, in an audit conducted in accordance with Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133), the auditor should apply a financial statement materiality consideration in reporting in the *Government Auditing Standards* report fraud and illegal acts involving federal awards that are subject to Circular A-133 reporting. That is because those findings already are reported in the Circular A-133 report and reporting findings that are not material to the financial statements again in the *Government Auditing Standards* report would be unnecessarily duplicative. Paragraphs 4.29–.34 describe *Government Auditing Standards* requirements for presenting audit findings. Exhibit 4-1 is a flowchart that illustrates the evaluation and reporting of findings of fraud and noncompliance under *Government Auditing Standards* when the auditee is not subject to an audit in accordance with Circular A-133. (Chapter 13, "Auditor

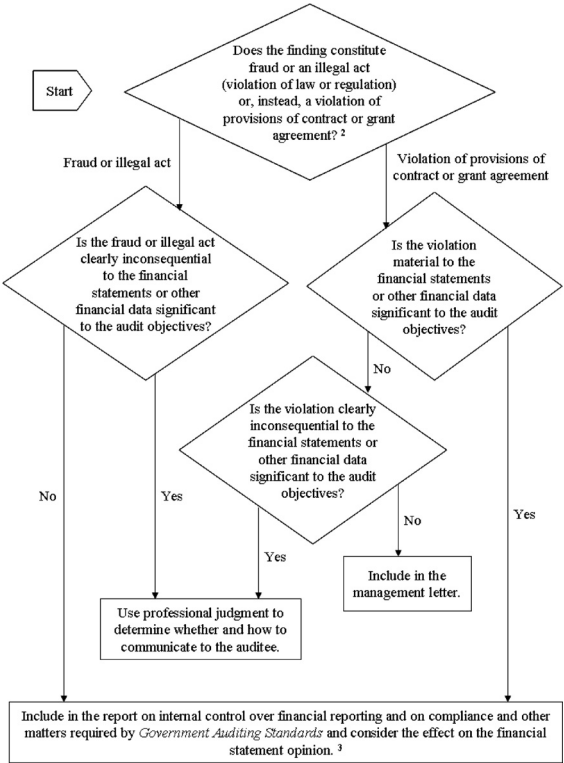
¹⁵ Alternatively, the auditor may decide to communicate solely with those charged with governance.

¹⁶ Chapter 10, "Compliance Auditing Applicable to Major Programs," discusses the auditor's consideration of fraud risk in an audit of an auditee's compliance with specified requirements applicable to its major programs in an audit conducted in accordance with Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133).

Reporting Requirements and Other Communication Considerations in a Single Audit," of this guide presents a flowchart that illustrates the evaluation and reporting of findings of fraud and noncompliance under *Government Auditing Standards* when the auditee is subject to an audit in accordance with Circular A-133.) Chapter 3 of this guide includes a flowchart that illustrates its discussion of the evaluation and reporting of findings of abuse.

Exhibit 4-1

Evaluation and Reporting of Findings of Fraud and Noncompliance Under *Government Auditing Standards*¹



¹ This flowchart represents the evaluation and reporting of findings of fraud and noncompliance (illegal acts and violations of provisions of contracts or grant agreements) under *Government Auditing Standards* when the auditee is not subject to an audit in accordance with Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133). Chapter 13, "Auditor Reporting Requirements and Other Communication Considerations in a Single Audit," of this guide presents a flowchart that illustrates the evaluation and reporting of findings of fraud and noncompliance under *Government Auditing Standards* when the auditee is subject to an audit in accordance with Circular A-133.

² The auditor should consider the direct reporting requirement of *Government Auditing Standards*. Paragraphs 4.20–.21 discuss the requirements in paragraphs 5.18–.20 of *Government Auditing Standards* that auditors report fraud and noncompliance directly to parties outside of the auditee in certain circumstances.

³ Paragraph 4.30 discusses how to report noncompliance findings that relate to both internal control over financial reporting and to compliance. Paragraph 4.31 discusses when to report fraud findings in the internal control section of the report or instead in the section on compliance and other matters.

4.17 As indicated in exhibit 4-1, *Government Auditing Standards* has differing standards for including in the report on internal control over financial reporting and on compliance and other matters (a) noncompliance that is an illegal act (that is, violations of law or regulation) as compared to (b) noncompliance that is a violation of provisions of contract or grant agreements. The reporting for (a) is a threshold of "an effect on the financial statements that is more than inconsequential," whereas the reporting for (b) is a higher threshold of "material to the determination of financial statement amounts or other financial data significant to the audit." Consequently, it is important that auditors carefully evaluate whether compliance requirements arise from laws or regulations or, instead, from provisions of contracts or grant agreements. Often, contracts and grant agreements have compliance requirements that are based in law or regulation but those contracts or agreements do not indicate that laws or regulations are the source of the provisions. Further, it may not be apparent whether a document that provides guidance on the provisions of contracts or grant agreements (such as a program management or procedures manual) has the standing of a regulation. The auditor may need to consult with program administrators, grantors, pass-through entities, oversight agencies, legal counsel, or others about the source and standing of compliance requirements.

4.18 When fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse either have occurred or are likely to have occurred, auditors may consult with authorities or legal counsel about whether publicly reporting the information would compromise investigative or legal proceedings. Auditors may limit their public reporting to matters that would not compromise those proceedings (and for example, only report that information that is already a part of the public record).

4.19 As indicated in exhibit 4-1 and in the discussion and flowchart of abuse in chapter 3 of this guide, paragraph 5.16 of *Government Auditing Standards* provides guidance for reporting fraud and illegal acts that are inconsequential, immaterial violations of provisions of contracts or grant agreements, and immaterial abuse. Violations of provisions of contracts or grant agreements or abuse that have an effect on the financial statements that is less than material but more than inconsequential should be communicated in writing to officials of the audited entity. Determining whether and how to communicate to officials of the audited entity fraud, illegal acts, violations of provisions of contract or grant agreements, or abuse that is inconsequential is a matter of professional judgment. Auditors should document such communications. See table 4-1 and paragraph 4.37.

Direct Reporting of Fraud, Illegal Acts, Violations of Provisions of Contracts or Grant Agreements, and Abuse

4.20 Paragraphs 5.18–.20 of *Government Auditing Standards* provide guidance on the direct reporting of fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse. *Government Auditing Standards* state that in addition to any legal requirements for the direct reporting of those situations, auditors should report them directly to parties outside of the auditee in the following two circumstances. Auditors should comply with these requirements even if they have resigned or been dismissed from the audit:

- a. When entity management fails to satisfy legal or regulatory requirements to report such information to external parties specified in law or regulation, auditors should first communicate the failure

to report such information to those charged with governance. If auditors have communicated such situations to those charged with governance and the audited entity still does not report the information to the external parties as soon as practical, then the auditors should report the information directly to the specified external parties.

- b. When entity management fails to take timely and appropriate steps to respond to known or likely fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse that is (1) likely to have a material effect on the financial statements and (2) involves funding received directly or indirectly from a government agency, auditors should first report management's failure to take timely and appropriate steps to those charged with governance. If the audited entity still does not take timely and appropriate steps as soon as practicable after the auditors' communication with those charged with governance, then the auditors should report the entity's failure to take timely and appropriate steps directly to the funding agency.

4.21 In both of these situations, auditors should obtain sufficient appropriate audit evidence (for example, by confirmation with outside parties) to corroborate assertions by management that it has reported fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse in accordance with laws, regulations, and funding agreements. If they are unable to do so, the auditors should report the fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse directly, as discussed previously.

Report on the Financial Statements

4.22 The auditor's standard report on the financial statements identifies the financial statements audited in an opening (introductory) paragraph, describes the nature of an audit in a scope paragraph, and expresses the auditor's opinion on the financial statements in an opinion paragraph.¹⁷ See the illustrative reports in appendix A (paragraph 4.51), examples 4-1 and 4-2. The basic elements of the report are¹⁸

- a. a title that includes the word *independent*.
- b. a statement that the financial statements identified in the report were audited.
- c. a statement that the financial statements are the responsibility of the auditee's management and that the auditor's responsibility is

¹⁷ Because an audit of a government's financial statements under the provisions of the AICPA Audit and Accounting Guide *State and Local Governments* is based on opinion units (see footnote 1 in paragraph 4.01), the auditor's report on those financial statements may include more than 1 opinion paragraph.

¹⁸ Interpretation No. 17, "Clarification in the Audit Report of the Extent of Testing of Internal Control Over Financial Reporting in Accordance With Generally Accepted Auditing Standards," of AU section 508, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 9508 par. .85–.88), provides wording that may be added to the auditor's standard report on the financial statements of a nonissuer to clarify differences between a GAAS audit and an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (PCAOB). Paragraphs .85–.88 of Interpretation No. 17 explain how the auditor may modify the report if engaged to also follow PCAOB Auditing Standards in the audit of a nonissuer. See the further discussion in appendix A (paragraph 4.51).

to express an opinion on the financial statements based on his or her audit.

- d. a statement that the audit was conducted in accordance with GAAS and an identification of the United States of America as the country of origin of those standards (for example, auditing standards generally accepted in the United States of America or U.S. GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.^{19,20} (See paragraph 4.24–.25.)
- e. a statement that those standards require that the auditor plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.
- f. a statement that an audit includes
 - i. examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements.
 - ii. assessing the accounting principles used and significant estimates made by management.
 - iii. evaluating the overall financial statement presentation.
- g. a statement that the auditor believes that the audit provides a reasonable basis for his or her opinion.
- h. an opinion on whether the financial statements are fairly presented, in all material respects, in conformity with GAAP.²¹ The opinion should include an identification of the United States of America as the country of origin of those accounting principles (for example, accounting principles generally accepted in the United States of America or U.S. GAAP).
- i. a reference to the separate report on internal control over financial reporting and on compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters prepared in accordance with *Government Auditing Standards*,²² which includes a statement that the purpose of that report is to describe the scope of testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. This statement should be modified if the auditor is providing an opinion on internal control over financial reporting or on compliance in the *Government Auditing Standards* report. The reference also should include a statement that the separate report is an integral part of an audit performed in accordance with *Government*

¹⁹ For financial audits performed in accordance with chapters 1–5 of *Government Auditing Standards*, July 2007 revision, apply. The standards applicable to financial audits are the general, fieldwork, and reporting standards described in chapters 3–5 of *Government Auditing Standards*.

²⁰ *Government Auditing Standards* paragraph 3.04 states that when personal, external, and organizational impairments to independence exist, a government auditor who cannot decline to perform the work because of a legislative requirement or for other reasons must disclose the impairment and modify the compliance statement.

²¹ If an auditee prepares OCBOA financial statements, the auditor still is required to express or disclaim an opinion. AU section 623 provides guidance related to reporting on OCBOA financial statements. See also footnote 3 in paragraph 4.03.

²² Paragraphs 4.04, 4.08–.10, and 4.27–.28 discuss the report on internal control over financial reporting and on compliance and other matters based on a financial statement audit in accordance with *Government Auditing Standards*.

Auditing Standards and important for assessing the results of the audit. If the reporting on internal control over financial reporting and on compliance and other matters is included in the report on the financial statements, the reference to the separate report is not required. (This guide recommends separate reporting; see paragraph 4.05*b*.)

- j. the manual or printed signature of the auditor's firm.
- k. the date of the audit report.

4.23 As discussed in paragraph 4.03, various professional standards provide reporting guidance if the basic financial statements are accompanied by or required to be accompanied by information presented outside the basic financial statements. Those standards may require additional language in the auditor's report on the financial statements. The illustrative report in appendix A (paragraph 4.51), example 4-1, includes paragraphs reporting on RSI and SI.²³

4.24 As discussed in paragraph 4.05*a*, when the report on the financial statements is submitted to comply with a requirement for an audit in accordance with *Government Auditing Standards*, or when those standards are voluntarily followed, the report should include a *Government Auditing Standards* compliance statement. An unmodified compliance statement should be used when the auditor has (a) followed all applicable unconditional and presumptively mandatory *Government Auditing Standards* requirements or (b) have followed all unconditional requirements and documented justification for any departure from applicable presumptively mandatory requirements and have achieved the objectives of those requirements through other means. This guide recommends the following language be included in the auditor's report to meet this requirement: "We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States."

4.25 A modified compliance statement should be used when the requirements for the unmodified compliance statement are not met. One situation the auditor should consider using a modified compliance statement is in the case of a scope limitation, such as restrictions on access to records, government officials, or other individuals needed to conduct the audit. When a modified compliance statement is used, the auditor should disclose the applicable requirement(s) that was not followed, the reason for not following the requirement(s), and how not following the requirement(s) affected, or could have affected, the audit and the assurance provided. A modified compliance statement is made by stating that (1) the auditor performed the audit in accordance with *Government Auditing Standards*, except for specific applicable requirements that were not followed, or (2) because of the significance of the departure(s) from the requirements, the auditor was unable to and did not perform the audit in accordance with *Government Auditing Standards*. When the auditors do not comply with any applicable requirements, they should (1) assess the significance of the non-compliance to the audit objectives, (2) document the assessment, along with their reasons for not following the requirement, and (3) determine the type of

²³ Chapter 13, "Auditor Reporting Requirements and Other Communication Considerations in a Single Audit," of this guide discusses and illustrates auditor reporting on the supplementary schedule of expenditures of federal awards required by Circular A-133.

Government Auditing Standards compliance statement. The auditor's determination will depend on the significance of the requirements not followed in relation to the audit objectives.

4.26 Paragraph 5.06 of *Government Auditing Standards* acknowledges that an auditee may need a financial statement audit for purposes other than to comply with a requirement calling for an audit in accordance with *Government Auditing Standards*. For example, the auditee may need a financial statement audit to issue bonds, or for other financing purposes. In that case, *Government Auditing Standards* permits auditors to issue a separate report on the financial statements conforming only to the requirements of GAAS or other applicable standards.²⁴

Report on Internal Control Over Financial Reporting and Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

4.27 This guide recommends combining into one report the reporting required by *Government Auditing Standards* on the scope and results of testing of the auditee's internal control over financial reporting and compliance with laws, regulations, and provisions of contracts or grant agreements and other matters, which concern certain fraud and abuse. (Paragraph 4.31 discusses the placement of findings relating to "other matters.")

4.28 The following lists the basic elements of the auditor's standard report on internal control over financial reporting and on compliance and other matters based on an audit of the financial statements in accordance with *Government Auditing Standards*. See the illustrative reports in appendix A (paragraph 4.51), examples 4-3, 4-5, and 4-7, and the discussion of the presentation of findings and the views of responsible officials and their planned corrective actions in paragraphs 4.29–.36:

- a. A statement that the auditor has audited the financial statements of the auditee and a reference to the auditor's report on the financial statements, including a description of any departure from the standard report (see appendix A [paragraph 4.51] and, examples 4-4 and 4-6 for illustrations acknowledging that the financial statement report was modified to include a reference to other auditors and the related discussion in paragraphs 4.42–.48).
- b. A statement that the audit was conducted in accordance with GAAS and an identification of the United States of America as the country

²⁴ The AICPA Audit and Accounting Guide *State and Local Governments* discusses auditor association with municipal securities filings and the use of *Government Auditing Standards* reports and references in the offering document—the official statement. Governments sometimes issue municipal securities to finance facilities for nongovernmental organizations, such as not-for-profit and health care organizations, and those nongovernmental organizations may be considered "obligated persons" with regard to the securities and thus also provide audited financial statements for the official statement. The AICPA Audit and Accounting Guide *State and Local Governments* states that the official statement should not include the reports required by *Government Auditing Standards* because those reports are restricted-use reports under the provisions of AU section 532, *Restricting the Use of an Auditor's Report* (AICPA, *Professional Standards*, vol. 1). Further, that guide states that it generally is advisable for the official statements to use an auditor's report on the financial statements that does not refer to the *Government Auditing Standards* audit or to those reports.

of origin of those standards (for example, auditing standards generally accepted in the United States of America or U.S. GAAS) and with the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. (See paragraphs 4.24–.25.)

- c. A statement that in planning and performing the audit, the auditor considered the auditee's internal control over financial reporting as a basis for designing the auditing procedures for the purpose of expressing an opinion on the financial statements and not for the purpose of expressing an opinion on the effectiveness of internal control over financial reporting, and accordingly, does not express an opinion on the effectiveness of the auditee's internal control over financial reporting.²⁵
- d. A statement that the auditor's consideration of internal control over financial reporting is not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses; if material weaknesses are noted, a statement that the auditor's consideration of internal control over financial reporting is not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified.
- e. The definitions of *deficiency in internal control* and *material weakness*.
- f. If material weaknesses are noted, a statement that certain deficiencies in internal control over financial reporting were identified that the auditor considers to be material weaknesses.
- g. If material weaknesses are identified, a description of the material weaknesses identified (including the views of responsible officials and their planned corrective action) or a reference to a separate schedule in which material weaknesses, views of responsible officials, and their planned corrective action are described.
- h. If significant deficiencies are noted, a statement that certain deficiencies in internal control over financial reporting were identified that the auditor considers to be significant deficiencies.
- i. If significant deficiencies are identified, a description of the significant deficiencies identified (including the views of responsible officials and their planned corrective action) or a reference to a separate schedule in which significant deficiencies, views of responsible officials, and their planned corrective action are described.²⁶
- j. If significant deficiencies are identified, the definition of a *significant deficiency*.

²⁵ If the auditor provides an opinion on internal control over financial reporting or on compliance (see footnote 6 in paragraph 4.05), this guide recommends that the reference to the separate report be modified to indicate that there is such an opinion.

²⁶ For an audit in accordance with Circular A-133, all findings, including those required to be reported under *Government Auditing Standards*, should be included in the schedule of findings and questioned costs. See the further discussion in chapter 13 of this guide.

- k. If no significant deficiencies are noted, a statement that no material weaknesses were identified; if significant deficiencies are noted, but no material weaknesses were identified, a statement that no material weaknesses were identified.
- l. A statement that as part of obtaining reasonable assurance about whether the auditee's financial statements are free of material misstatement, the auditor performed tests of the auditee's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts.
- m. A statement that providing an opinion on compliance with those provisions was not an objective of the audit and that, accordingly, the auditor does not express such an opinion.
- n. A statement that notes whether the results of tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*²⁷ and, if they are, describes the instances of noncompliance and other matters (including the views of responsible officials and their planned corrective action) or refers to the separate schedule in which the noncompliance and other matters, views of responsible officials, and their planned corrective action are described. When the views of responsible officials are included (auditee's written response), also include a statement that the auditor did not audit the auditee's response and, accordingly, expresses no opinion on it.
- o. If applicable, a statement that additional matters were communicated to the auditee in a management letter.²⁸
- p. A separate paragraph at the end of the report stating that the report is intended solely for the information and use of management, [identifying the body or individuals charged with governance], others within the entity, and [identifying the legislative or regulatory body]²⁹ and is not intended to be and should not be used by anyone other than these specified parties.³⁰
- q. The manual or printed signature of the auditor's firm.
- r. The date of the auditor's report. (Because the report on internal control over financial reporting and on compliance and other matters relates to the audit of the financial statements and is based on the GAAS audit procedures performed, it should carry the same date as the auditor's report on the financial statements.)

²⁷ Paragraph 4.16 discusses noncompliance and other matters—certain fraud and abuse—for which *Government Auditing Standards* requires reporting in the auditor's report. Paragraph 4.31 discusses where to report findings of fraud and abuse in the report on internal control over financial reporting and on compliance and other matters.

²⁸ Paragraph 4.37 discusses the *Government Auditing Standards* requirements for communicating in writing immaterial violations of provisions of contracts or grant agreements and immaterial abuse to officials of the audited entity.

²⁹ For an audit in accordance with Circular A-133, this reference should include federal awarding agencies and, if applicable, pass-through entities. See the further discussion in chapter 13 of this guide.

³⁰ This paragraph conforms to AU section 532. See AU section 532 for additional guidance on restricted-use reports.

Other Reporting and Communication Considerations

Findings Relating to the Financial Statements^{31, #}

4.29 As summarized in table 4-1, paragraph 5.10 of *Government Auditing Standards* states that the auditor should include findings for the following situations in the report on internal control over financial reporting and on compliance and other matters:

- Significant deficiencies in internal control over financial reporting (those that are, individually or in the aggregate, material weaknesses should be identified as such)
- All instances of fraud and illegal acts unless inconsequential³²
- Material violations of provisions of contracts and grant agreements
- Material abuse

4.30 As indicated in paragraph 4.28, the report on internal control over financial reporting and on compliance and other matters should either describe the findings indicated in paragraph 4.29 or refer to a separate schedule that describes them. (As discussed in paragraph 4.35, the auditor also should include the reporting of the auditee's views and planned corrective action.) Findings that relate to both internal control over financial reporting and to compliance are generally reported in both the section of the report concerning internal control over financial reporting and the section of the report concerning compliance and other matters. However, the reporting in one section of the report or schedule may be in summary form with a reference to a detailed reporting in the other section.

4.31 This guide recommends that the auditor present or refer to findings of fraud and abuse in the compliance and other matters section of the report, unless the primary nature of the finding is a significant deficiency in internal control. In that case, it is recommended that findings of fraud and abuse that represent significant deficiencies in internal control be presented in the internal control section. Neither *Government Auditing Standards* nor this guide requires the auditor's report to use the terms *fraud* or *abuse* in presenting or referring to such findings. The illustrative reports in examples 4-3–4-7 in appendix A (paragraph 4.51) illustrate language in the compliance and other matters section of the report to refer to findings that do or may include fraud and abuse. This guide recommends that this language appear in all reports, even if the report does not describe or refer to findings of fraud or abuse or even

³¹ There is no option for the auditor to report in a management letter, or other written communication, findings that *Government Auditing Standards* or Circular A-133 requires to be reported in the auditor's report or Schedule of Findings and Questioned Cost.

[#] See footnote II to the heading before paragraph 4.04 for more information on the use of SAS No. 115 guidance in reporting under *Government Auditing Standards*.

³² As discussed in paragraph 4.16, for an auditee that is subject to an audit in accordance with Circular A-133, the auditor should apply a financial statement materiality consideration in reporting in the *Government Auditing Standards* report fraud and illegal acts involving federal awards that are subject to Circular A-133 reporting. Because those findings already are reported in the Circular A-133 report, reporting findings that are not material to the financial statements again in the *Government Auditing Standards* report would be unnecessarily duplicative. Chapter 13 of this guide discusses that reporting.

if the only findings of fraud or abuse are described in or referred to from the section on internal control over financial reporting.

4.32 Paragraph 5.22 of *Government Auditing Standards* states that auditors should place their findings in proper perspective by describing the nature and extent of the issues being reported and the extent of the work performed that resulted in the finding. To give the reader a basis to judge the prevalence and consequences of the findings, the instances that are identified should be related to the population or the number of cases examined and be quantified in terms of dollar value or other measure, as appropriate. If the results cannot be projected, auditors should limit their conclusions appropriately.

4.33 In presenting audit findings, paragraph 5.21 of *Government Auditing Standards* states that auditors should develop the elements of the findings to the extent necessary to achieve the audit objectives. The elements of a finding are (a) criteria (the required or desired state), (b) condition (the situation that exists), (c) cause (why it happened), and (d) effect or potential effect (the difference between the situation that exists and the required or desired state). Paragraphs 4.15–.18 of *Government Auditing Standards* further describe those 4 elements. Clearly developed findings assist management or oversight officials of the audited entity in understanding the need for taking corrective action. In addition, if auditors sufficiently develop the elements of a finding, they may provide recommendations for corrective action.

4.34 This guide recommends that each audit finding reported in accordance with *Government Auditing Standards* explicitly address each of the elements referred to previously to the extent necessary to achieve the audit objective and that each finding be assigned a reference number.³³ One option for assigning reference numbers is to use the fiscal year being audited as the beginning digits of each reference number, followed by a numeric sequence. For example, findings identified and reported in the audit of fiscal year 20X1 would be assigned reference numbers 20X1-1, 20X1-2, and so forth.

Reporting Views of Responsible Officials and Planned Corrective Action

4.35 As discussed in paragraph 4.05f, if the auditor's report includes findings, paragraph 5.32 of *Government Auditing Standards* states that auditors should obtain and report the views of responsible officials concerning the findings, conclusions, and recommendations, as well as planned corrective actions.³⁴ Auditors should include in their report a copy of the officials' written comments or a summary of the comments received. Auditors should also include in the report an evaluation of the comments, as appropriate. Obtaining the comments in writing is preferred, but oral comments are acceptable. When the auditor receives oral comments, the auditor should summarize those comments and provide a copy of the summary to the entity's officials to verify their accuracy before finalizing the report. Paragraph 5.37 of *Government Auditing Standards* provides that if the auditee's comments are inconsistent with or in conflict with

³³ As discussed in chapter 13 of this guide, when performing a Circular A-133 compliance audit, Circular A-133 requires all findings (including findings related to the audit of the financial statements for which *Government Auditing Standards* requires reporting) to have a reference number.

³⁴ As discussed in chapter 2 of this guide, when establishing an understanding with an auditee in the engagement letter, the auditor may consider including a statement about the need and timing for developing the views of responsible officials and planned corrective action.

the report's findings, conclusions, or recommendations, and are not, in the auditor's opinion, valid—or if the planned corrective actions do not adequately address the auditor's recommendations—the auditor should state reasons for disagreeing with the comments or planned corrective actions.³⁵ Conversely, if the auditors find the comments valid and supported by sufficient appropriate evidence, they should modify their report as necessary. As set forth in paragraph .26 of AU section 325, when a written response to the auditor's findings are included in a report, the auditor may add a statement disclaiming an opinion on such information. An example of such a statement is "[Insert Entity's name]'s written response to the significant deficiencies [and material weaknesses] identified in our audit has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it."

4.36 If the audited entity refuses to provide comments or is unable to provide them within a reasonable amount of time, *Government Auditing Standards* states that the auditor may issue the report without receiving comments from the audited entity. If, however, the auditee does not provide the necessary information by the time the report is released, the report should indicate that the audited entity did not provide comments.

Other Written Communications

4.37 Paragraphs 5.16 of *Government Auditing Standards* states that auditors should communicate in writing violations of provisions of contracts or grant agreements or abuse that have an effect on the financial statements that is less than material but more than inconsequential (see table 4-1).^{36,37} This communication may be done in a management letter. As noted in paragraph 5.09 of *Government Auditing Standards*, if auditors issue or intend to issue a management letter that contains items required to be communicated to entity officials, they should refer to that management letter in the report on internal control over financial reporting and on compliance and other matters. As discussed in paragraph 4.49, auditors should not include personal identification or other potentially sensitive matters in the management letter. Examples 4-3–4-7 and in appendix A (paragraph 4.51) illustrate references to the management letter. *Government Auditing Standards* directs auditors to use professional judgment to determine whether and how to communicate to auditee officials fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse that is inconsequential.³⁸ Paragraph 5.16 of *Government Auditing Standards* states that auditors should document such communications.

³⁵ In an audit in accordance with Circular A-133, the auditee is required to submit a corrective action plan. For those audits, depending on the status of the development of the corrective action plan at the time the auditor's reports are released, the auditor may be able to refer to the corrective action plan to satisfy as the required presentation of the auditee's views and planned corrective actions. See the further discussion in chapter 13 of this guide.

³⁶ Generally, *Government Auditing Standards* requires the auditor to evaluate findings for the purpose of this communication based on their consequence to the financial statements or other financial data significant to the audit objectives. As discussed in chapter 13 of this guide, however, in an audit in accordance with Circular A-133, the auditor should evaluate findings involving federal awards for the purpose of that communication based only on their consequence to the financial statements.

³⁷ See footnote 31 to the heading before paragraph 4.29.

³⁸ As discussed in paragraph 4.12, AU section 316, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1), whenever the auditor has determined that there is evidence that fraud may exist, the auditor should bring that matter to the attention of an appropriate level of management, even if the matter might be considered inconsequential.

4.38 Auditors often use a management letter to communicate information to the auditee about ways to improve operational efficiency and effectiveness or otherwise improve internal control or other policies or procedures (other than those for which communication is required by GAAS or *Government Auditing Standards*). In communicating information in a management letter, auditors could consider wording the discussions so that readers can distinguish those matters that are required to be included by GAAS or *Government Auditing Standards* from matters that are recommendations for improvements or information about "best practices." When a management letter is issued only for the purpose of providing management with efficiency comments or to communicate nonsignificant deficiencies (and does not contain any items required to be communicated under *Government Auditing Standards*), a reference to the management letter does not need to be put in the auditor's reports.

Portions of the Entity Not Audited in Accordance With *Government Auditing Standards*

4.39 Because of the provisions of GAAP, entities that are required to have an audit in accordance with *Government Auditing Standards* sometimes include in their financial statements organizational units that are not required to have such an audit. For example, Governmental Accounting Standards Board Statement No. 14, *The Financial Reporting Entity*, as amended, requires reporting entity financial statements to include component units. Similarly, Financial Accounting Standards Board *Accounting Standards Codification* 958-810-25 requires presentation of consolidated financial statements when one not-for-profit entity (NFP) (the parent) controls the voting majority of the board of directors and has an economic interest in another NFP. When included organizational units do not have an audit in accordance with *Government Auditing Standards*, the auditor should consider modifying his or her reports on the financial statements and on internal control over financial reporting and on compliance and other matters, as discussed in the following paragraphs.

4.40 With regard to the report on the financial statements of a governmental reporting entity, consolidated NFP, or other consolidated entity, if a material portion of the organization (such as a component unit or fund³⁹) is not required to have an audit in accordance with *Government Auditing Standards*, the auditor should modify the scope paragraph of the report on the financial statements to indicate the portion of the entity that was not audited in accordance with *Government Auditing Standards*. Example wording follows:

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of [name of the portion of the

³⁹ Because an audit of a government's financial statements under the provisions of the AICPA Audit and Accounting Guide *State and Local Governments* is based on opinion units (see footnote 1 in paragraph 4.01), the auditor's consideration of materiality in this instance should be considered in terms of the materiality of the component unit or fund to its related opinion unit. See that guide for further guidance.

entity, such as the name of the component unit or fund]⁴⁰ were not audited in accordance with *Government Auditing Standards*. An audit includes examining . . .

4.41 With regard to the report on the internal control over financial reporting and on compliance and other matters, the auditor should modify the opening scope paragraph to indicate the portion of the entity that was not audited in accordance with *Government Auditing Standards*. Example wording for a state or local government follows:

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of Example Entity as of and for the year ended June 30, 20X1, which collectively comprise Example Entity's basic financial statements and have issued our report thereon dated August 15, 20X1. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The financial statements of [name of component unit or fund] were not audited in accordance with *Government Auditing Standards*.

Other Auditors

4.42 AU section 543, *Part of Audit Performed by Other Independent Auditors* (AICPA, *Professional Standards*, vol. 1), and paragraphs .12–.13 of AU section 508 provide requirements and guidance regarding the report on the financial statements when more than 1 independent auditor is involved in an audit of an entity's financial statements.

4.43 A principal auditor who refers to the work of other auditors in the report on an entity's financial statements also should acknowledge the involvement of the other auditors in the report on internal control over financial reporting and compliance and other matters issued for that entity. The principal auditor has two options for making such an acknowledgement:

1. Referring to the other auditors involvement in the principal auditor's report and indicating that the results of the other audits are not included—the *reference option*.
2. Referring to the other auditors involvement in the principal auditor's report and including the results of the other audits (for example, material weaknesses, material instances of noncompliance, significant deficiencies, and abuse)—the *inclusion option*.

Regardless of which of the preceding options is chosen by the auditor, the principal auditor is not responsible for the specific findings of the other auditors.

4.44 The reference option and the inclusion option are equally acceptable. When planning the engagement, the principal auditor should consider discussing with the auditee how other auditors' results will be addressed in the principal auditor's report on internal control over financial reporting and compliance and other matters. The principal auditor also may want to discuss

⁴⁰ For audits of a state or local government's financial statements, if it is not evident from the financial statements to which opinion unit the component unit or fund relates, the auditor should consider identifying the opinion unit in addition to the name of the component unit or fund.

with the auditee and with the other auditors the timing of reports from other auditors to ensure an understanding of expectations. This guide recommends that the principal auditor use only one option in a report (that is, not referencing the results of some other auditors' work and including the results of others). Paragraphs 4.45–.48 describe considerations relating to the inclusion option. Example 4-4 in appendix A (paragraph 4.51) provides illustrative report wording for the reference option, and example 4-6 provides illustrative wording for the inclusion option.

4.45 When relying on the reports of other auditors for the fair presentation of basic financial statements, the principal auditor often has to take steps to ensure other auditors' reports are issued timely so that the principal auditor's report on the fair presentation of the reporting entity's financial statements can be issued timely. The same effort also is necessary for the report on internal control over financial reporting and on compliance and other matters required by *Government Auditing Standards* when the principal auditor chooses to use the inclusion option and include other auditors' results. Communication, planning, establishing deadlines, and monitoring are important to ensure that the issuance of the principal auditor's report is not delayed because one or more other auditors have not issued their reports. Establishing and successfully implementing this approach calls for coordination with both the auditee and the other auditors.

4.46 The principal auditor's decision to use the inclusion option may be affected by various factors that may complicate the gathering and assessment of other auditors' work. For example, large governments may have many component units audited by other auditors and the principal auditor may need to obtain, analyze, and include numerous results from other auditors' reports. Further, the other auditors' reports on internal control over financial reporting and compliance and other matters may not be issued in final form when the principal auditor's report is issued. Finally, the audits performed by other auditors may not be performed under *Government Auditing Standards*.⁴¹

4.47 With both options, the principal auditor's report on internal control over financial reporting and compliance and other matters should identify the organizations, functions, or activities audited by other auditors and whether any of those audits were not performed under *Government Auditing Standards*⁴² in the introductory paragraph as well as refer to the principal auditor's report on the financial statements:

- a. With the reference option, ordinarily the introductory paragraph also states that the report on internal control over financial reporting and compliance and other matters does not include the results of the audits performed by other auditors.

⁴¹ For situations in which the other auditors did not perform their audits under *Government Auditing Standards*, there is nothing to preclude the principal auditor from including in the report on internal control over financial reporting and on compliance and other matters the significant deficiencies and material weaknesses that the other auditors communicated to meet the requirements of AU section 325. However, if such AU section 325 communication is included, this guide recommends that the opening paragraph of example 4-6 in appendix A (paragraph 4.51) be modified to explain that, although certain of the audits were not performed under *Government Auditing Standards*, the deficiencies in internal control from those audits are included in the reporting.

⁴² See example 4-4, footnotes 38–39, and example 4-6 in appendix A (paragraph 4.51) for illustrations of the report wording in situations in which some or all of the other auditor's audits were not performed under *Government Auditing Standards*.

- b. With the inclusion option, the principal auditor analyzes the results of the other audits to determine which findings, if any, may be included in the principal auditor's report on internal control over financial reporting and compliance and other matters. The principal auditor exercises professional judgment in evaluating those results for inclusion using the materiality levels appropriate for the scope of for the principal auditor's audit. For example, an internal control weakness that is a significant deficiency at the organizational unit level when it is separately audited may not rise to the level of a significant deficiency when considered in the context of materiality for the entity covered by the principal auditor's audit. Because an audit of a government's financial statements under the provisions of the AICPA Audit and Accounting Guide *State and Local Governments* is based on opinion units (see footnote 1 in paragraph 4.01), the auditor's consideration of the results of the other audits should address each opinion unit. Table 4-3 provides guidance to assist the principal auditor in exercising judgment in this analysis process for an audit of a government taking into consideration the opinion unit concept.

Table 4-3
Inclusion Option: Guidance for Determining Whether to Include the Other Auditors' Findings in the Principal Auditor's Report on Internal Control Over Financial Reporting and Compliance and Other Matters for an Audit of a Government

| <i>The Other Auditors Perform the Audit of</i> | <i>The Other Auditors' Reports Include Material Weakness(es), Material Noncompliance, or Material Abuse</i> | <i>The Other Auditors Reports Include Significant Deficiencies</i> | <i>The Other Auditors Reported Matters Required by Government Auditing Standards to Be communicated in writing¹</i> |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------|
| One or more complete opinion units (for example, the other auditors report on the financial statements of a major fund or of the aggregate discretely presented component unit opinion unit in its entirety) | Include the other auditors' findings in the principal auditor's report ² | Include the other auditors' findings in the principal auditor's report | Exclude the other auditors' findings from the principal auditor's report |
| Material portion of an opinion unit (for example, the other auditors report on the financial statements of a department that is a material portion | Include the other auditors' findings in the principal auditor's report | Use professional judgment in considering whether to include the other auditors' findings in the principal auditor's report | Exclude the other auditors' findings from the principal auditor's report |

| <i>The Other Auditors Perform the Audit of</i> | <i>The Other Auditors' Reports Include Material Weakness(es), Material Noncompliance, or Material Abuse</i> | <i>The Other Auditors Reports Include Significant Deficiencies</i> | <i>The Other Auditors Reported Matters Required by Government Auditing Standards to Be communicated in writing¹</i> |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------|
| of the financial statements of a major fund or the other auditor audits a discretely presented component unit that is material to the aggregate discretely presented component unit opinion unit) | | | |
| Immaterial portion of an opinion unit (for example, the other auditors report on the financial statements of component units that are an immaterial portion of the aggregate discretely presented component unit opinion unit) | Use professional judgment in considering whether to include the other auditors' finding in the principal auditor's report ³ | Use professional judgment in considering whether to include the other auditors' findings in the principal auditor's report | Exclude the other auditors' findings from the principal auditor's report |

¹ As noted in paragraph 4.37, *Government Auditing Standards* require the auditor to communicate in writing violations of provisions of contracts or grant agreements or abuse that have an effect on the financial statements that is less than material but more than inconsequential. Such communication may be made in a management letter. Paragraph 5.09 of *Government Auditing Standards* states that the auditor's report on internal control and on compliance and other matters should refer to the management letter. Therefore, for situations in which the principal auditor or the other auditors have issued management letters that include matters required to be reported under *Government Auditing Standards*, the principal auditor's report should include a reference to its own management letter, as well as those of the other auditors. Example 4-6 in appendix A (paragraph 4.51) provides illustrative report wording for this situation.

² For example, if the other auditor reports a material weakness or material noncompliance for a major enterprise fund's stand alone financial statements, the principal auditor would include that material weakness or material noncompliance in the principal auditor's report.

³ For example, if the other auditor reports a material weakness for a nonmajor enterprise fund's stand alone financial statements, the principal auditor would consider the nature and significance of the material weakness in relation to the aggregate remaining fund information opinion unit in its entirety to determine whether to include that material weakness in the principal auditor's report.

4.48 For those material weaknesses, material instances of noncompliance, significant deficiencies, and abuse the principal auditor decides to include in the report, the auditor normally would include the description of the other auditors' results exactly as reported by the other auditors. However, in some circumstances the principal auditor may make minor changes to the descriptions of material weaknesses, material instances of noncompliance, significant deficiencies, and abuse (for example, to add clarity and perspective). Before making any changes to such descriptions in the principal auditor's report, the auditor may consider discussing the proposed changes with the other auditors and document the results of that discussion. The principal auditor uses professional judgment in determining how best to organize the reporting of results of other auditors. For example, the principal auditor might organize the results by who identified them, describing the principal auditor's results first followed by the results of other auditors. If the principal auditor decides to organize all of the findings by subject matter or level of importance, the principal auditor could add appropriate language to each of the other auditors' results to make it clear which matters were identified by other auditors.

Freedom of Information Act and Similar Laws and Regulations

4.49 Often, federal, state, and local laws and regulations, such as the Freedom of Information Act (U.S. Code title 5, Section 552), require governments to release certain documents, including audit reports and management letters of organizations for which the government has oversight responsibilities, to members of the press and the general public. Other laws and regulations require that audit reports of governments be made publicly available. Accordingly, auditors should not include names, Social Security numbers, other personal identification, or other potentially sensitive matters in either the body of audit reports or any attached or referenced schedules or letters. Paragraph 5.39 of *Government Auditing Standards* states that if certain pertinent information is prohibited from public disclosure or is excluded from a report due to the confidential or sensitive nature of the information, auditors should disclose in the report that certain information has been omitted and the reason or other circumstances that make the omission necessary. In addition, paragraph 5.43 of *Government Auditing Standards* states when audit organizations are subject to public records laws, auditors should determine whether public records laws could impact the availability of classified or limited use reports and determine whether other means of communicating with management and those charged with governance would be more appropriate.

Assurance to Regulators and Oversight Agencies

4.50 Federal and state regulators and other oversight agencies sometimes require that independent auditors sign a document, such as a standardized form or questionnaire, to provide some level of assurance about an auditee's financial or other data or systems. Auditors may only provide assurance about such data and systems in a manner that complies with applicable professional standards.

4.51

Appendix A—Illustrative Auditor's Reports Under Government Auditing Standards*

This appendix contains examples of the reports issued under generally accepted auditing standards and *Government Auditing Standards* in various circumstances, based on the guidance found in AU section 325, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1). *Government Auditing Standards* requires that in addition to providing an opinion or a disclaimer of opinion on the financial statements,¹ auditors should report on the scope and results of testing of the auditee's internal control over financial reporting and compliance with laws, regulations, and provisions of contracts or grant agreements. They also should report certain fraud or abuse. Auditors should exercise professional judgment in any situation not specifically addressed in this guide. For additional guidance the auditor may refer to AU section 508, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1), and applicable AICPA Audit and Accounting Guides, such as *Health Care Entities*, *Not-for-Profit Entities*, and *State and Local Governments*.

| Example No. | Title |
|-------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 4-1 | Unqualified Opinions on Basic Financial Statements Accompanied by Required Supplementary Information and Supplementary Information—State or Local Governmental Entity |
| 4-2 | Unqualified Opinion on Financial Statements—Not-for-Profit Entity |
| 4-3 | Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i> (No Material Weaknesses No Significant Deficiencies Identified, No Reportable Instances of Noncompliance or Other Matters) |
| 4-4 | Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i> (for a Governmental Entity and With Reference to Audits by Other Auditors Using the Reference Option) (No Material Weaknesses Identified, No Significant Deficiencies Identified, No Reportable Instances of Noncompliance or Other Matters Identified) |

(continued)

* The reports in this appendix have been revised for Statement on Auditing Standards (SAS) No. 115, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 325), which is effective for periods ending on or after December 15, 2009.

¹ As explained in the AICPA Audit and Accounting Guide *State and Local Governments*, the auditor generally expresses or disclaims an opinion on a government's basic financial statements by providing an opinion or disclaimer of opinion on each opinion unit required to be presented in those financial statements. In addition, the auditor may provide opinions or disclaimers of opinions on additional opinion units if engaged to set the scope of the audit and assess materiality at a more detailed level than by the opinion units required for the basic financial statements. Throughout this guide, the use of the singular terms *opinion* and *disclaimer of opinion* encompasses the multiple opinions and disclaimers of opinion that generally will be provided on a government's financial statements. See example 4-1 for an example of reporting on state and local government financial statements.

| <i>Example No.</i> | <i>Title</i> |
|--------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 4-5 | Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i> (No Material Weaknesses Identified; Significant Deficiencies and Reportable Instances of Noncompliance, and Other Matters Identified) |
| 4-6 | Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i> (for a Governmental Entity and With Reference to Audits by Other Auditors Using the Inclusion Option) (No Material Weaknesses Identified; Significant Deficiencies, Reportable Instances of Noncompliance, and Other Matters Identified) |
| 4-7 | Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i> (Material Weaknesses and Significant Deficiencies and Reportable Instances of Noncompliance, and Other Matters Identified) |

Example 4-1**Unqualified Opinions on Basic Financial Statements Accompanied by Required Supplementary Information and Supplementary Information—State or Local Governmental Entity²**Independent Auditor's Report

[Addressee]

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Example, Any State, as of and for the year ended June 30, 20X1, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City of Example's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*,³ issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. [Optional: *An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we express no such opinion.*]⁴ An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.⁵

² Refer to the AICPA Audit and Accounting Guide *State and Local Governments* for additional guidance on reporting on a government's basic financial statements. In particular, appendix A to chapter 14 of that guide describes conditions that may make modifications of the standard report necessary and illustrates several of those modifications, such as reference to the work of other auditors.

³ For financial audits performed in accordance with *Government Auditing Standards*, chapters 1–5 of *Government Auditing Standards*, July 2007 revision, apply. The standards applicable to financial audits are the general, fieldwork, and reporting standards described in chapters 3–5 of *Government Auditing Standards*.

⁴ This optional wording may be added in accordance with Interpretation No. 17 "Clarification in the Audit Report of the Extent of Testing on Internal Control Over Financial Reporting in Accordance With Generally Accepted Auditing Standards," of AU section 508, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 9508 par. .85–.88), which provides reporting guidance for audits of nonissuers. Interpretation No. 17 also addresses how auditors may expand this report to explain that their consideration of internal control was sufficient to provide the auditor sufficient understanding to plan the audit and determine the nature, timing and extent of tests to be performed, but was not sufficient to express an opinion on the effectiveness of the internal control. If this optional wording is added, in an audit of a governmental entity, the remainder of the paragraph would read as follows:

An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

⁵ If the financial statements include organizational units that are not required to have a *Government Auditing Standards* audit, the auditor should consider modifying this scope paragraph as discussed and illustrated in paragraphs 4.39–.40.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Example, Any State, as of June 30, 20X1, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated [date of report] on our consideration of the City of Example's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters.⁶ The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance.⁷ That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The [identify accompanying required supplementary information, such as management's discussion and analysis and budgetary comparison information] on pages XX through XX and XX through XX are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America.⁸ We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.⁹

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Example's basic financial statements. The [identify accompanying supplementary information, such as the introductory section, combining and individual nonmajor fund financial statements, and statistical tables] are presented for purposes of additional analysis and are not a required part of the basic financial statements.¹⁰ The

⁶ Paragraph 4.16 discusses noncompliance and other matters—certain fraud and abuse—for which *Government Auditing Standards* requires reporting in the auditor's report.

⁷ This sentence should be modified if the auditor is providing an opinion on internal control over financial reporting or on compliance in the *Government Auditing Standards* report. See footnote 6 to paragraph 4.05b.

⁸ The auditor may identify the body requiring the information, which in this situation is the Governmental Accounting Standards Board.

⁹ Generally accepted accounting principles require that the financial statements of state and local governments be accompanied by a management's discussion and analysis, and may require that they be accompanied by other required supplementary information (RSI). The auditor may be required to or choose to report on that information. This example assumes such reporting. AU section 558A, *Required Supplementary Information* (AICPA, *Professional Standards*, vol. 1); AU section 551A, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents* (AICPA, *Professional Standards*, vol. 1); and the AICPA Audit and Accounting Guide *State and Local Governments* contain guidance on the auditor's responsibilities for and reporting on RSI. See footnotes † and ‡ in paragraph 4.03 for information related to recently issued SASs that will replace the guidance discussed in this footnote.

¹⁰ If the financial statements are accompanied by supplementary information other than RSI (known as SI), the auditor may be required to or choose to report on that information. This example assumes such reporting. AU section 550A, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1); AU section 551A; and the AICPA Audit

(continued)

[*identify relevant supplementary information, such as the combining and individual nonmajor fund financial statements*] have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.¹¹ The [*identify relevant supplementary information, such as the introductory section and statistical tables*] have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

[*Signature*]

[*Date*]

(footnote continued)

and Accounting Guide *State and Local Governments* contain guidance on the auditor's responsibilities for and reporting on SI. In addition, in an audit in accordance with Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133), the financial statements should be accompanied by a supplementary schedule of expenditures of federal awards and the auditor should report whether that schedule is presented fairly in all material respects in relation to the financial statements taken as a whole. Chapter 13, "Auditor Reporting Requirements and Other Communication Considerations in a Single Audit," of this guide illustrates wording for this paragraph in that situation. See footnotes * and † in paragraph 4.03 for information related to recently issued SASs that will replace the guidance discussed in this footnote.

¹¹ When reporting on SI, the auditor should consider the effect of any modifications to the report on the basic financial statements (for example, a qualified opinion, a modification as to consistency because of a change in accounting principle, or a reference to the report of other auditors). Furthermore, if the report on SI is other than unqualified, this paragraph should be modified. Paragraphs .09–.11 and .13–.14 of AU section 551A provide guidance for reporting in these circumstances.

Example 4-2

Unqualified Opinion on Financial Statements—Not-for-Profit Entity¹²

Independent Auditor's Report

[Addressee]

We have audited the accompanying statement of financial position of Example NPO as of June 30, 20X1, and the related statements of activities and cash flows¹³ for the year then ended. These financial statements are the responsibility of Example NPO's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*,¹⁴ issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. [Optional: *An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Example NPO's internal control over financial reporting. Accordingly, we express no such opinion.*]¹⁵ An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.¹⁶

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Example NPO as of June 30, 20X1, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated [date of report] on our consideration of Example NPO's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters.¹⁷ The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that

¹² Refer to the AICPA Audit and Accounting Guide *Not-for-Profit Entities* for additional guidance on reporting on the financial statements of a not-for-profit entity. In addition to the situations discussed in that guide, auditors may need to modify the report on the financial statements to refer to the work of other auditors, using the guidance in AU section 543, *Part of Audit Performed by Other Independent Auditors* (AICPA, *Professional Standards*, vol. 1).

¹³ Each of the statements presented, which may include a statement of functional expenses, should be identified in the introductory paragraph.

¹⁴ See footnote 3.

¹⁵ See footnote 4. If this optional wording is added, in an audit of a nongovernmental entity, the remainder of the paragraph would read as follows:

An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

¹⁶ See footnote 5.

¹⁷ See footnote 6.

testing, and not to provide an opinion on internal control over financial reporting or on compliance.¹⁸ That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.¹⁹

[Signature]

[Date]

¹⁸ See footnote 7.

¹⁹ If the financial statements are accompanied by RSI or SI (for example, a comparison of actual and budgeted expenses), the auditor may be required to or choose to report on that information in one or more paragraphs following this paragraph. AU section 550A, AU section 551A, and AU section 558A, contain guidance on the auditor's responsibilities for and reporting on RSI and SI. See also footnote 11. In addition, in an audit in accordance with Circular A-133, the financial statements should be accompanied by a supplementary schedule of expenditures of federal awards and the auditor should report whether that schedule is presented fairly in all material respects in relation to the financial statements taken as a whole. Chapter 13 of this guide illustrates wording for this paragraph in that situation.

Example 4-3

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters²⁰ Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards* (No Material Weaknesses Identified, No Significant Deficiencies Identified, No Reportable Instances of Noncompliance or Other Matters Identified)²¹

[Addressee]

We have audited the financial statements²² of Example Entity as of and for the year ended June 30, 20X1, and have issued our report thereon dated August 15, 20X1.²³ We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*,²⁴ issued by the Comptroller General of the United States.²⁵

Internal Control Over Financial Reporting^{26,27}

In planning and performing our audit, we considered Example Entity's internal control over financial reporting as a basis for designing our auditing procedures

²⁰ Chapters 2, "Planning Considerations of *Government Auditing Standards*," and 3, "Financial Statement Audit Considerations of *Government Auditing Standards*," of this guide discuss the auditor's consideration of internal control over financial reporting and of fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse.

²¹ The portions of examples 4-3 and 4-5 that apply to a specific auditee situation may be used in drafting the report. For example, if the auditor has identified significant deficiencies but has not identified instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, the internal control section of example 4-5 may be used along with the compliance and other matters section of this report. Alternatively if the auditor has not identified significant deficiencies but has identified instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, the internal control section of this report may be used along with the compliance section of example 4-5. See example 4-7 for illustrative reporting for situations in which the auditor has identified material weaknesses.

²² As explained in the AICPA Audit and Accounting Guide *State and Local Governments*, the auditor generally expresses or disclaims an opinion on a government's basic financial statements by providing an opinion or disclaimer of opinion on each opinion unit required to be presented in those financial statements. (See footnote 1.) For audits of governmental entities, the first sentence in this report would be modified to reflect the opinion units that have been reported on. In addition, the first sentence under the heading "Internal Control over Financial Reporting" would be revised to refer to "our opinions" instead of "our opinion." An illustration of the revised wording for the first sentence follows:

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of Example Entity as of and for the year ended June 30, 20X1, which collectively comprise Example Entity's basic financial statements and have issued our report thereon dated August 15, 20X1.

²³ Describe any departure from the standard report (for example, a qualified opinion, a modification as to consistency because of a change in accounting principle, or a reference to the report of other auditors).

²⁴ See footnote 3.

²⁵ If the financial statements include organizational units that are not required to have a *Government Auditing Standards* audit, the auditor should consider modifying this scope paragraph. See paragraphs 4.39 and 4.41.

²⁶ *Government Auditing Standards* permits, but does not require, auditors to express an opinion on internal control over financial reporting or on compliance if sufficient work was performed.

²⁷ This report sequences the reporting on internal control over financial reporting before the reporting on compliance and other matters. However, the Circular A-133 reports in appendixes A in chapters 13 and 14, "Program-Specific Audits," of this guide sequence the reporting on compliance before the reporting on internal control over compliance. Auditors may present the internal control and compliance sections of the *Government Auditing Standards* and Circular A-133 reports in whichever sequence better meets their needs.

for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Example Entity's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Example Entity's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters²⁸

As part of obtaining reasonable assurance about whether Example Entity's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of Example Entity in a separate letter dated August 15, 20X1.²⁹

This report is intended solely for the information and use of management, [identify the body or individuals charged with governance], others within the entity, and [identify the legislative or regulatory body]³⁰ and is not

²⁸ Other matters are certain findings of fraud or abuse. As per industry practice, the reference to "other matters" in both the heading and the following paragraph typically appears in all reports, even if the report does not present or refer to findings of fraud or abuse or even if the only findings of fraud or abuse are presented in or referred to from the section on internal control over financial reporting. (See paragraphs 4.37–38.)

²⁹ *Government Auditing Standards* requires the auditor to communicate in writing to officials of the audited entity violations of provisions of contracts or grant agreements or abuse that have an effect on the financial statements that is less than material but more than inconsequential. Paragraph 5.09 of *Government Auditing Standards* requires the reference illustrated in this paragraph if the auditor has issued a management letter reporting such matters. This reference does not preclude the auditor from including other discussions or recommendations in the management letter. See paragraphs 4.37–38.

³⁰ For an audit in accordance with Circular A-133, this sentence should include a reference to federal awarding agencies and, if applicable, pass-through entities. See the further discussion in chapter 13 of this guide.

intended to be and should not be used by anyone other than these specified parties.³¹

[Signature]

[Date]³²

³¹ This paragraph conforms to AU section 532, *Restricting the Use of an Auditor's Report* (AICPA, *Professional Standards*, vol. 1). See AU section 532 for additional guidance on restricted-use reports.

³² Because this report relates to the audit of the financial statements, and is based on the generally accepted auditing standards audit procedures performed, it is subject to the provisions of AU section 530, *Dating of the Independent Auditor's Report* (AICPA *Professional Standards*, vol. 1). Therefore, it should be dated the same date as the auditor's report on the financial statements, which per paragraph .01 of AU section 530 is "no earlier than the date on which the auditor obtains sufficient appropriate audit evidence."

Example 4-4

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters³³ Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards* (for a Governmental Entity and With Reference to Audits by Other Auditors Using the Reference Option)³⁴ (No Material Weaknesses Identified, No Significant Deficiencies Identified, No Reportable Instances of Noncompliance or Other Matters Identified)³⁵

[Addressee]

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of Example Entity as of and for the year ended June 30, 20X1, which collectively comprise Example Entity's basic financial statements and have issued our report thereon dated August 15, 20X1. Our report includes a reference to other auditors.³⁶ We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*,³⁷ issued by the Comptroller General of the United States. Other auditors audited the financial statements of [identify organization, function, or activity], as described in our report on Example Entity's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.^{38,39}

³³ See footnote 20.

³⁴ See paragraphs 4.43–.45 for discussion of the reference option for acknowledging the involvement of other auditors in the report on internal control over financial reporting and compliance and other matters.

³⁵ The portions of examples 4-4 and 4-5 that apply to a specific auditee situation may be used in drafting the report. For example, if the auditor has identified significant deficiencies but has not identified instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, the internal control section of example 4-5 may be used along with the compliance and other matters section of this report. Alternatively, if the auditor has not identified significant deficiencies but has identified instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, the internal control section of this report may used along with the compliance section of example 4-5. See example 4-7 for illustrative reporting for situations in which the auditor has identified material weaknesses.

³⁶ Also describe any other departures from the standard report (for example, a qualified opinion or a modification as to consistency because of a change in accounting principle).

³⁷ See footnote 3.

³⁸ There may be circumstances in which none of the other auditors' audits referred to in the financial statement report were performed under *Government Auditing Standards*. To clarify the portion that was not audited in accordance with *Government Auditing Standards*, the scope paragraph should be modified. The last sentence in this paragraph may be replaced with the following:

The financial statements of [identify organization, function, or activity] were not audited in accordance with *Government Auditing Standards*.

See also paragraph 4.41 for additional guidance on modifying the scope paragraph when the financial statements include organizational units that are not required to have a *Government Auditing Standards* audit. Paragraph 4.40 provides guidance on similar modifications to the report on the financial statements.

³⁹ There may be circumstances in which some other auditors' audits were not performed under *Government Auditing Standards*, whereas some other auditors' audits were performed under those

(continued)

Internal Control Over Financial Reporting^{40,41}

In planning and performing our audit, we considered Example Entity's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Example Entity's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Example Entity's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters⁴²

As part of obtaining reasonable assurance about whether Example Entity's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of Example Entity in a separate letter dated August 15, 20X1.⁴³

(footnote continued)

standards. In that situation, the scope paragraph should be modified. An additional sentence may be added to this paragraph as follows:

The financial statements of [identify organizations, functions, or activities audited by other auditors that were not performed under *Government Auditing Standards*] were not audited in accordance with *Government Auditing Standards*.

See also paragraph 4.41 for additional guidance on modifying the scope paragraph when the financial statements include organizational units that are not required to have a *Government Auditing Standards* audit. Paragraph 4.40 provides guidance on similar modifications to the report on the financial statements.

⁴⁰ See footnote 26.

⁴¹ See footnote 27.

⁴² See footnote 28.

⁴³ See footnote 29.

This report is intended solely for the information and use of management, [*identify the body or individuals charged with governance*], others within the entity, and [*identify the legislative or regulatory body*]⁴⁴ and is not intended to be and should not be used by anyone other than these specified parties.⁴⁵

[*Signature*]

[*Date*]⁴⁶

⁴⁴ See footnote 30.

⁴⁵ See footnote 31.

⁴⁶ See footnote 32.

Example 4-5

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters⁴⁷ Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards* (No Material Weaknesses Identified; Significant Deficiencies and Reportable Instances of Noncompliance, and Other Matters Identified)⁴⁸

[Addressee]

We have audited the financial statements⁴⁹ of Example Entity as of and for the year ended June 30, 20X1, and have issued our report thereon dated August 15, 20X1.⁵⁰ We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*,⁵¹ issued by the Comptroller General of the United States.⁵²

Internal Control Over Financial Reporting^{53,54}

In planning and performing our audit, we considered Example Entity's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Example Entity's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Example Entity's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying [include the title of the schedule in which the findings are reported (e.g., *schedule of findings and responses* or *schedule of findings and questioned costs*)] that we consider to be significant deficiencies in internal control over financial reporting. [List the reference numbers of the related findings, for example, 20X1-1, 20X1-3, and 20X1-4]. A *significant deficiency* is a deficiency, or a combination

⁴⁷ See footnote 20.

⁴⁸ See footnote 21.

⁴⁹ See footnote 22.

⁵⁰ See footnote 23.

⁵¹ See footnote 3.

⁵² See footnote 25.

⁵³ See footnote 26.

⁵⁴ See footnote 27.

of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

[**NOTE:** As discussed in paragraph 4.34, this guide recommends identifying each finding with a reference number. As discussed in paragraph 4.30, this report can, as an alternative, describe findings rather than refer to a separate schedule. Paragraph 4.30 also discusses how to report findings that relate to both internal control over financial reporting and to compliance; paragraph 4.31 discusses when findings of fraud and abuse may be reported in the section on internal control over financial reporting; paragraphs 4.32–.33 discuss the detail to use to present each finding; and paragraphs 4.35–.36 discuss the presentation of the views of responsible officials and their planned corrective actions. Further, in an audit in accordance with Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133), findings related to the financial statements which are required to be reported in accordance with *Government Auditing Standards* should be reported in the schedule of findings and questioned costs. The schedule of findings and questioned costs shown in example 13-5 in appendix A in chapter 13, "Auditor Reporting Requirements and Other Communication Considerations in a Single Audit" of this guide further describes the presentation of financial statement findings.]

Compliance and Other Matters⁵⁵

As part of obtaining reasonable assurance about whether Example Entity's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*⁵⁶ and which are described in the accompanying [include the title of the schedule in which the findings are reported (e.g., schedule of findings and responses or schedule of findings and questioned costs)] as items [list the reference numbers of the related findings, for example, 20X1-2 and 20X1-5].

[**NOTE:** The referenced findings include reportable: (a) instances of noncompliance; and (b) fraud or abuse that is not the result of a significant deficiency (See paragraphs 4.16 and 4.31). The "Note" in the internal control section of this example report further discusses the presentation of findings and auditee responses.]

We noted certain matters that we reported to management of Example Entity in a separate letter dated August 15, 20X1.⁵⁷

⁵⁵ See footnote 28.

⁵⁶ Paragraphs 4.16–.17 discuss the *Government Auditing Standards* criteria for reporting fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse. It is important to note within that discussion that in an audit conducted in accordance with Circular A-133, the auditor should apply a financial statement materiality consideration in reporting in the *Government Auditing Standards* report fraud and illegal acts involving federal awards that are subject to Circular A-133 reporting. That is because those findings already are reported in the Circular A-133 report and reporting findings that are not material to the financial statements again in the *Government Auditing Standards* report would be unnecessarily duplicative.

⁵⁷ See footnote 29.

Example Entity's response to the findings identified in our audit are described in the accompanying [*include the title of the schedule in which the findings are reported (e.g., schedule of findings and responses or schedule of findings and questioned costs)*] "or above" if findings and responses are included in the body of the report]. We did not audit Example Entity's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, [*identify the body or individuals charged with governance*], others within the entity, and [*identify the legislative or regulatory body*]⁵⁸ and is not intended to be and should not be used by anyone other than these specified parties.⁵⁹

[Signature]

[Date]⁶⁰

⁵⁸ See footnote 30.

⁵⁹ See footnote 31.

⁶⁰ See footnote 32.

Example 4-6

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters⁶¹ Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards* (for a Governmental Entity and With Reference to Audits by Other Auditors Using the Inclusion Option)⁶² (No Material Weaknesses Identified; Significant Deficiencies, Reportable Instances of Noncompliance, and Other Matters Identified)⁶³

[Addressee]

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of Example Entity as of and for the year ended June 30, 20X1, which collectively comprise Example Entity's basic financial statements and have issued our report thereon dated August 15, 20X1. Our report includes a reference to other auditors.⁶⁴ We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*,⁶⁵ issued by the Comptroller General of the United States. Other auditors audited the financial statements of [identify organization, function, or activity], as described in our report on Example Entity's financial statements. This report includes our consideration of the results of the other auditor's testing of internal control over financial reporting and compliance and other matters that are reported on separately by those other auditors. However, this report, insofar as it relates to the results of the other auditors, is based solely on the reports of the other auditors.⁶⁶

Internal Control Over Financial Reporting^{67,68}

In planning and performing our audit, we considered Example Entity's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Example Entity's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Example Entity's internal control over financial reporting.

⁶¹ See footnote 20.

⁶² See paragraphs 4.43–.48 for discussion of the inclusion option for acknowledging the involvement of other auditors in the report on internal control over financial reporting and compliance and other matters.

⁶³ The portions of examples 4-3 and 4-7 and this report that apply to a specific auditee situation may be used in drafting the report. For example, if the auditor has identified significant deficiencies but has not identified instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, the internal control section of this report may be used along with the compliance and other matters section of example 4-3. Alternatively, if the auditor has not identified significant deficiencies but has identified instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, the internal control section of example 4-3 may be used along with the compliance section of this report. If the auditor has identified material weaknesses, the structure of internal control section of example 4-7 may be used. However, because examples 4-3 and 4-7 do not assume other auditor involvement, similar wording to that noted in this report relating to other auditors may be incorporated.

⁶⁴ See footnote 36.

⁶⁵ See footnote 3.

⁶⁶ See footnote 39.

⁶⁷ See footnote 26.

⁶⁸ See footnote 27.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We and the other auditors did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we and the other auditors identified certain deficiencies in internal control over financial reporting, described in the accompanying [include the title of the schedule in which the findings are reported (e.g., schedule of findings and responses or schedule of findings and questioned costs)] that we consider to be significant deficiencies in internal control over financial reporting. [List the reference numbers of the related findings, for example, 20X1-1, 20X1-3, and 20X1-4]. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

[**NOTE:** As discussed in paragraph 4.34, this guide recommends identifying each finding with a reference number. As discussed in paragraph 4.30, this report can, as an alternative, describe findings rather than refer to a separate schedule. Paragraph 4.30 also discusses how to report findings that relate to both internal control over financial reporting and to compliance; paragraph 4.31 discusses when findings of fraud and abuse may be reported in the section on internal control over financial reporting; paragraph 4.46 discusses considerations relating to including other auditors' results; paragraphs 4.32–.33 discuss the detail to use to present each finding; and paragraphs 4.35–.36 discuss the presentation of the views of responsible officials and their planned corrective actions. Further, in an audit in accordance with Circular A-133, findings related to the financial statements which are required to be reported in accordance with *Government Auditing Standards* should be reported in the schedule of findings and questioned costs. The schedule of findings and questioned costs shown in example 13-5 in appendix A in chapter 13 of this guide further describes the presentation of financial statement findings.]

Compliance and Other Matters⁶⁹

As part of obtaining reasonable assurance about whether Example Entity's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests and those of the other auditors disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing*

⁶⁹ See footnote 28.

*Standards*⁷⁰ and which are described in the accompanying [include the title of the schedule in which the findings are reported (e.g., schedule of findings and responses or schedule of findings and questioned costs)] as items [list the reference numbers of the related findings, for example, 20X1-2 and 20X1-5].

We also noted certain matters that we reported to management of Example Entity in a separate letter dated August 15, 20X1.⁷¹

[NOTE: *The referenced findings in this section include those that are instances of noncompliance and those that are fraud or abuse that are not significant deficiencies. (See paragraph 4.31.) The "Note" in the internal control section of this example report further discusses the presentation of findings and auditee responses.*]

Example Entity's response to the findings identified in our audit are described in the accompanying [include the title of the schedule in which the findings are reported (e.g., schedule of findings and responses or schedule of findings and questioned costs) "or above" if findings and responses are included in the body of the report]. We did not audit Example Entity's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, [identify the body or individuals charged with governance], others within the entity, and [identify the legislative or regulatory body]⁷² and is not intended to be and should not be used by anyone other than these specified parties.⁷³

[Signature]

[Date]⁷⁴

⁷⁰ See footnote 56.

⁷¹ See footnote 29.

⁷² See footnote 30.

⁷³ See footnote 31.

⁷⁴ See footnote 32.

Example 4-7

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters⁷⁵ Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards* (Material Weaknesses and Significant Deficiencies and Reportable Instances of Noncompliance, and Other Matters Identified)⁷⁶

[Addressee]

We have audited the financial statements⁷⁷ of Example Entity as of and for the year ended June 30, 20X1, and have issued our report thereon dated August 15, 20X1.⁷⁸ We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*,⁷⁹ issued by the Comptroller General of the United States.⁸⁰

Internal Control Over Financial Reporting^{81,82}

In planning and performing our audit, we considered Example Entity's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Example Entity's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Example Entity's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying [*include the title of the schedule in which the findings are reported (e.g., schedule of findings and responses or schedule of findings and questioned costs)*], we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses [*and other deficiencies that we consider to be significant deficiencies*].⁸³

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing

⁷⁵ See footnote 20.

⁷⁶ The portions of examples 4-3 and 4-7 that apply to a specific auditee situation may be used to draft the report. The internal control section of this example 4-7 may be used if the auditor has identified material weaknesses. If the auditor has identified material weaknesses but has not identified instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, the internal control section of example 4-7 may be used along with the compliance and other matters section of example 4-3.

⁷⁷ See footnote 22.

⁷⁸ See footnote 23.

⁷⁹ See footnote 3.

⁸⁰ See footnote 25.

⁸¹ See footnote 26.

⁸² See footnote 27.

⁸³ If no significant deficiencies are identified, the text within the brackets is omitted from the report.

their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying [include the title of the schedule in which the findings are reported (e.g., *schedule of findings and responses* or *schedule of findings and questioned costs*)] to be material weaknesses. [List the reference numbers of the related findings, for example, 20X1-1, 20X1-3, and 20X1-4].

[A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying [include the title of the schedule in which the findings are reported (e.g. *schedule of findings and responses* or *schedule of findings and questioned costs*)] to be significant deficiencies. (List the reference numbers of the related findings, for example, 20X1-2 and 20X1-5.)]⁸⁴

[**NOTE:** As discussed in paragraph 4.34, this guide recommends identifying each finding with a reference number. As discussed in paragraph 4.30, this report can, as an alternative, describe findings rather than refer to a separate schedule. Paragraph 4.30 also discusses how to report findings that relate to both internal control over financial reporting and to compliance; paragraph 4.31 discusses when findings of fraud and abuse may be reported in the section on internal control over financial reporting; paragraphs 4.32–.33 discuss the detail to use to present each finding; and paragraphs 4.35–.36 discuss the presentation of the views of responsible officials and their planned corrective actions. Further, in an audit in accordance with Circular A-133, findings related to the financial statements which are required to be reported in accordance with *Government Auditing Standards* should be reported in the schedule of findings and questioned costs. The schedule of findings and questioned costs shown in example 13-5 in appendix A in chapter 13 of this guide further describes the presentation of financial statement findings.]

Compliance and Other Matters⁸⁵

As part of obtaining reasonable assurance about whether Example Entity's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*⁸⁶ and which are described in the accompanying [include the title of the schedule in which the findings are reported (e.g., *schedule of findings and responses* or *schedule of findings and questioned costs*)] as items [list the reference numbers of the related findings, for example, 20X1-2 and 20X1-5].

[**NOTE:** The referenced findings should include reportable: (a) instances of noncompliance; and (b) fraud or abuse that is not the result of a significant

⁸⁴ See footnote 83.

⁸⁵ See footnote 28.

⁸⁶ See footnote 56.

deficiency (See paragraphs 4.16 and 4.31). The "Note" in the internal control section of this example report further discusses the presentation of findings and auditee responses.]

We noted certain matters that we reported to management of Example Entity in a separate letter dated August 15, 20X1.⁸⁷

Example Entity's response to the findings identified in our audit are described in the accompanying *[include the title of the schedule in which the findings are reported (e.g., schedule of findings and responses or schedule of findings and questioned costs) "or above" if findings and responses are included in the body of the report]*. We did not audit Example Entity's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, *[identify the body or individuals charged with governance]*, others within the entity, and *[identify the legislative or regulatory body]*⁸⁸ and is not intended to be and should not be used by anyone other than these specified parties.⁸⁹

[Signature]

*[Date]*⁹⁰

⁸⁷ See footnote 29.

⁸⁸ See footnote 30.

⁸⁹ See footnote 31.

⁹⁰ See footnote 32.

Part II

Circular A-133 Audits

Chapter 5

Overview of the Single Audit Act, Circular A-133, and the Compliance Supplement

Note: The audit required by the Single Audit Act Amendments of 1996 and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, should be performed in accordance with *Government Auditing Standards*. Part I, "Government Auditing Standards Audits," (chapters 2–4 of this guide) discusses financial statement audits under generally accepted auditing standards (GAAS) and *Government Auditing Standards*. The guidance in parts I and II, "Circular A-133 Audits," (chapters 5–14 of this guide) is applicable for those auditors performing an audit under the Single Audit Act Amendments of 1996 and Circular A-133.

Information related to the American Recovery and Reinvestment Act of 2009 (Recovery Act) can be found in a section located at the end of each chapter in part II of this guide. See the section titled "American Recovery and Reinvestment Act Considerations" beginning at paragraph 5.49 in this chapter. See also the preface section titled "Impact of the American Recovery and Reinvestment Act of 2009 on Single Audits."

Introduction¹

5.01 This chapter provides an overview of the significant requirements and guidance in the Single Audit Act Amendments of 1996; OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133);² and the *OMB Circular A-133 Compliance Supplement* (*Compliance Supplement*). As discussed in paragraph 5.08, the Single Audit Act Amendments of 1996 and Circular A-133 require nonfederal entities that expend \$500,000 or more of federal awards in a fiscal year to have a single or program-specific audit. Refer to the Single Audit Act Amendments of 1996, Circular A-133, and the *Compliance Supplement* for a complete understanding of the requirements. Appendixes A and B of this guide reprint the Single Audit Act Amendments of 1996 and Circular A-133. Footnote 14 in paragraph 5.48 provides instructions for obtaining the *Compliance Supplement*.

¹ In chapters 5–14, the use of the terms *single audit* or *audit in accordance with Circular A-133* includes both the financial statement audit and the compliance audit that is performed under Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133). The use of the term *Circular A-133 compliance audit* includes only the compliance audit that is performed under Circular A-133.

² Because Circular A-133 incorporates the requirements of the Single Audit Act Amendments of 1996, the requirements of Circular A-133 and the act often are discussed together as one in this guide. Accordingly, references to Circular A-133 also include the requirements of the Single Audit Act Amendments of 1996.

5.02 The Single Audit Act Amendments of 1996 was enacted to streamline and improve the effectiveness of audits of federal awards and to reduce the audit burden on states, local governments, and not-for-profit entities (NFPs). The Single Audit Act Amendments of 1996 and Circular A-133 require auditors to perform single and program-specific audits of federal awards in accordance with *Government Auditing Standards*, which incorporates the fieldwork and reporting standards of GAAS and the related Statements on Auditing Standards (SASs) issued by the AICPA unless the Comptroller General of the United States excludes them by formal announcement.³ The Single Audit Act Amendments of 1996 requires the audits to be conducted by an independent auditor.⁴ The Single Audit Act Amendments of 1996 gives the Director of OMB the authority to develop government-wide guidelines and policy on performing audits to comply with the act. The OMB issued Circular A-133 to establish audit guidelines and policy for a uniform system of auditing states, local governments, and NFPs that expend federal awards.⁵ Individual federal departments and agencies have adopted Circular A-133 in regulation.

Single Audit Act and Circular A-133 Requirements

Objectives of a Single Audit

5.03 In a single audit, the auditor has the following objectives, each of which results in the issuance of certain auditor reports (as discussed in chapter 13, "Auditor Reporting Requirements and Other Communication Considerations in a Single Audit," and chapter 14, "Program-Specific Audits," of this guide):

- Audit of the entity's financial statements and reporting on the schedule of expenditures of federal awards
 - determine whether the financial statements of the auditee are presented fairly in all material respects in conformity with generally accepted accounting principles (GAAP). (Note that Circular A-133 does not prescribe the basis of accounting for financial statement preparation.) (See the further discussion in chapter 6, "Planning Considerations of Circular A-133," of this guide.)
 - determine whether the schedule of expenditures of federal awards is presented fairly in all material respects in relation to the auditee's financial statements taken as a whole. (See also chapter 7, "Schedule of Expenditures of Federal Awards.")

³ To date, the Comptroller General has not excluded any fieldwork or reporting standards or related Statements on Auditing Standards (SASs).

⁴ The Single Audit Act Amendments of 1996 defines *independent auditor* as (a) an external state or local government auditor who meets the independence standards included in *Government Auditing Standards* or (b) a public accountant who meets such independence standards. Chapter 2, "Planning Considerations of *Government Auditing Standards*," of this guide discusses the independence requirements of *Government Auditing Standards*.

⁵ Circular A-133 was first revised and issued on June 30, 1997. That revision superseded OMB Circular A-128, *Audits of State and Local Governments*, and all previous versions of Circular A-133. The June 30, 1997, revision was subsequently revised by changes published in the *Federal Register* on June 27, 2003 and again by changes published in the *Federal Register* on June 26, 2007. Circular A-133, as revised on June 26, 2007, is available at www.whitehouse.gov/omb/grants_circulars/.

- Compliance audit of federal awards
 - obtain an understanding of the internal control over compliance for each major program, assess the control risk of noncompliance,⁶ and perform tests of those controls unless the controls are deemed to be ineffective. (The auditor should perform procedures to obtain an understanding of internal control over federal programs that is sufficient to plan the audit to support a low assessed level of control risk of noncompliance for each major program.) (See also chapter 9, "Consideration of Internal Control Over Compliance for Major Programs.")
 - determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements pertaining to federal awards that may have a direct and material effect on each of its major programs (hereinafter referred to as *compliance requirements*). (See also chapter 10, "Compliance Auditing Applicable to Major Programs.")

Audit of an Entity's Financial Statements and Reporting on the Schedule of Expenditures of Federal Awards

5.04 The financial statement audit required by Circular A-133 is performed in accordance with the standards applicable to financial audits contained in GAAS and *Government Auditing Standards*.⁷ That audit results in the auditor reporting on the entity's financial statements and on the scope of the auditor's testing of compliance and internal control over financial reporting and the results of those tests. The auditor also should report certain fraud and abuse. The primary sources of guidance and standards regarding financial statement audits are the AICPA SASs;⁸ *Government Auditing Standards*; and the AICPA Audit and Accounting Guides, including *Health Care Entities*, *Not-for-Profit Entities*, and *State and Local Governments*. Chapter 6 of this guide discusses financial statement audit considerations under Circular A-133.

5.05 Circular A-133 also requires the auditor to determine and report on whether the schedule of expenditures of federal awards is presented fairly in all material respects in relation to the financial statements taken as a whole. AU section 551A,^{*} *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents* (AICPA, *Professional Standards*,

⁶ In part II of this guide, the term *control risk of noncompliance* is used in order to be consistent with the term as used and defined in SAS No. 117, *Compliance Audits* (AICPA, *Professional Standards*, vol. 1, AU sec. 801). The term *control risk* is used only when directly citing Circular A-133. Both terms have the same meaning.

⁷ In performing audits in accordance with the standards applicable to financial audits contained in *Government Auditing Standards*, the auditor assumes certain responsibilities beyond those of audits performed in accordance with generally accepted auditing standards (GAAS). Chapter 2, chapter 3, "Financial Statement Audit Considerations of *Government Auditing Standards*," and chapter 4, "Auditor Reporting Requirements and Other Communication Considerations of *Government Auditing Standards*," of this guide discuss those responsibilities.

⁸ SASs are codified in AICPA *Professional Standards* volume 1. See the section in the preface "References to Professional Standards" for further explanation.

^{*} SAS No. 119, *Supplementary Information in Relation to the Financial Statements as a Whole* (AICPA, *Professional Standards*, vol. 1, AU sec. 551), was issued in February 2010. This SAS addresses and clarifies the auditor's responsibility when engaged to opine on whether supplementary

(continued)

vol. 1), and paragraph .07 of AU section 550A,[†] *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1), provide guidance on such reporting on the schedule of expenditures of federal awards. Chapter 7 of this guide discusses the schedule of expenditures of federal awards and chapter 13 of this guide discusses the auditor's reporting on the schedule.

Circular A-133 Compliance Audit of Federal Awards

5.06 Under the Single Audit Act Amendments of 1996 and Circular A-133, the auditor has additional testing and reporting responsibilities for compliance, as well as internal control over compliance, beyond a financial statement audit performed in accordance with GAAS and *Government Auditing Standards*. SAS No. 117, *Compliance Audits* (AICPA, *Professional Standards*, vol. 1, AU sec. 801),[‡] applies when an auditor is engaged, or required by law or regulation, to perform a compliance audit in accordance with all of the following: (a) GAAS, (b) the standards for financial audits under *Government Auditing Standards*, and (c) a governmental audit requirement⁹ that requires an auditor to express an opinion on compliance. It is the primary source of guidance and standards regarding compliance audits. However, the guidance clarifies that SAS No. 117 does not apply to the financial statement audit component of a compliance audit. The Circular A-133 compliance audit of federal awards expended during the fiscal year provides a basis for issuing an additional report on compliance and on internal control over compliance related to major programs. Table 5-1 in paragraph 5.07 presents the additional compliance testing and internal control requirements relating to the Circular A-133 compliance audit of federal awards expended. Circular A-133 defines *major programs*; chapter 8, "Determination of Major Programs," of this guide discusses that definition. Chapters 9–11 of this guide discuss auditing considerations applicable to compliance and internal control over compliance related to major programs.

(footnote continued)

information is fairly stated, in all material respects, in relation to the financial statements as a whole. The SAS is effective for audits of financial statements for periods beginning on or after December 15, 2010. Early implementation is permitted. Upon its effective date, SAS No. 119, along with SAS No. 118, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 550), will supersede the requirements and guidance in AU section 551A, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents* (AICPA, *Professional Standards*, vol. 1).

[†] SAS No. 118 was issued in February 2010. This SAS addresses and clarifies the auditor's responsibility in relation to other information in documents containing audited financial statements and the auditor's report thereon. The SAS is effective for audits of financial statements for periods beginning on or after December 15, 2010. Early implementation is permitted. Upon its effective date, SAS No. 118 will supersede the requirements and guidance in AU section 550A, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1), and, along with SAS No. 119, the requirements in AU section 551A.

[‡] SAS No. 117, issued in December 2009, supersedes SAS No. 74, *Compliance Auditing Considerations in Audits of Governmental Agencies and Recipients of Governmental Financial Assistance* (AICPA, *Professional Standards*, vol. 1, AU sec. 801A), and updates the guidance in AU section 801. It clarifies the applicability of GAAS to a compliance audit and provides guidance to auditors regarding both auditing and reporting on an entity's compliance with applicable compliance requirements. SAS No. 117 is effective for compliance audits for fiscal periods ending on or after June 15, 2010, with early application permitted. This edition of the guide has been updated to include the requirements and guidance in SAS No. 117.

⁹ SAS No. 117 defines a *governmental audit requirement* as a government requirement established by law, regulation, rule, or provision of contracts or grant agreements requiring that an entity undergo an audit of its compliance with applicable compliance requirements related to one or more government programs that the entity administers. An example of a governmental audit requirement is Circular A-133.

5.07 The additional compliance testing and internal control responsibilities related to a Circular A-133 compliance audit are presented in the following table.

Table 5-1
Additional Compliance Testing and Internal Control Responsibilities

| | <i>Fieldwork Responsibilities</i> | <i>Reporting Responsibilities</i> |
|-------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Compliance Testing Responsibilities | The auditor should determine whether the entity complied with laws, regulations, and the provisions of contracts or grant agreements pertaining to federal awards that may have a direct and material effect on each major program. | The auditor should express an opinion on whether the entity complied with laws, regulations, and with the provisions of contracts or grant agreements that could have a direct and material effect on each major program and, where applicable, refer to a separate schedule of findings and questioned costs. |
| Internal Control Responsibilities | With regard to internal control over compliance, the auditor should (1) perform procedures to obtain an understanding of internal control over federal programs that is sufficient to plan the audit to support a low assessed level of control risk of noncompliance for major programs, (2) plan the testing of internal control over major programs to support a low assessed level of control risk of noncompliance for the assertions relevant to the compliance requirements for each major program, ¹ and (3) perform tests of internal control (unless the internal control is likely to be ineffective in preventing or detecting noncompliance). The auditor may use evidence gained from the tests of controls relevant to compliance requirements to determine the nature, timing, and extent of the testing required to express an opinion on compliance with requirements that have a direct and material effect on major federal programs. | The auditor should provide a written report on internal control over major programs describing the scope of testing internal control and the results of the tests, and, where applicable, refer to a separate schedule of findings and questioned costs. |

¹ Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133), requires the auditor to plan the audit to support a low assessed level of control risk of noncompliance for major programs; however, it does not actually require the auditor to achieve a low assessed level of control risk of noncompliance. Chapter 9, "Consideration of Internal Control Over Compliance for Major Programs," of this guide further discusses that Circular A-133 provision.

General Audit Requirements

Audit Threshold

5.08 Circular A-133 states that nonfederal entities that expend \$500,000 or more of federal awards (as discussed in paragraphs 5.09–.15) in a fiscal year should have a single or program-specific audit. Entities expending awards under only 1 program (excluding research and development [R&D]) may elect to have a program-specific audit if the program's laws, regulations, or grant agreements do not require a financial statement audit. A program-specific audit may not be elected for R&D unless (a) all expenditures are for awards received from the same federal agency or from the same federal agency and the same pass-through entity and (b) advance approval is obtained. (Chapter 14 provides additional guidance on program-specific audits.) Entities that expend less than \$500,000 in a fiscal year in federal awards are exempt from audit requirements in the Single Audit Act Amendments of 1996 and Circular A-133. However, those entities are not exempt from other federal requirements (including those to maintain records) concerning federal awards provided to the entity. Further, Section 200(d) of Circular A-133 states that records must be available for review or audit by appropriate officials of a federal agency, pass-through entity, and the U.S. Government Accountability Office (GAO). The Single Audit Act Amendments of 1996 provides that, every 2 years, the OMB may review the amount for requiring audits and may adjust the dollar threshold amount to no less than \$300,000.

Types of Federal Awards and Payment Methods

Definition of Federal Awards

5.09 Circular A-133 defines federal awards as *federal financial assistance* and *federal cost-reimbursement contracts* that auditees receive directly from federal awarding agencies or indirectly from pass-through entities. It does not include procurement contracts (under grants or contracts) used to buy goods or services from vendors. Paragraph 5.28 discusses subrecipient and vendor determinations.

Federal Financial Assistance—Classification and Types

5.10 Federal financial assistance is classified into program categories in the *Catalog of Federal Domestic Assistance* (CFDA), published by the Government Printing Office. (An electronic searchable version of the CFDA is available at www.cfda.gov.) Circular A-133 defines a federal program as all federal awards under the same CFDA number. Federal programs that have been designated as a cluster should be treated as one program when determining major programs. R&D, student financial aid (SFA), and certain other programs are defined as a cluster in the *Compliance Supplement* because they are closely related and share common compliance requirements. (Paragraphs 5.47–.48 discuss the *Compliance Supplement*. See paragraph 5.31 for a discussion of clusters of programs.)

5.11 Sometimes state governments combine funding from different federal awards in providing assistance to their subrecipients when the awards are closely related programs and share common compliance requirements. In this case, Circular A-133 states that the state may require the subrecipient to treat the combined federal awards as a cluster of programs, as discussed in paragraph 5.31.

5.12 There are more than 1,000 individual grant programs. Many of these programs are described in the CFDA; however, certain programs may not be included. For example, contracts may not be listed in the CFDA. Circular A-133 states that when a CFDA number is not assigned, all federal awards from the same agency that are made for the same purpose should be combined and considered 1 program.

5.13 Programs in the CFDA are classified into 15 types of assistance. Benefits and services are provided through 7 financial and 8 nonfinancial types of assistance. The following list describes the 8 principal types of assistance that are available:

- *Formula grants.* For activities of a continuing nature not confined to a specific project, allocations of money to nonfederal entities are made in accordance with a distribution formula prescribed by law or administrative regulation. One example is the Department of Agriculture's award to land-grant universities for cooperative extension services. Another example is the Department of Justice's award to state and local governments for drug control and systems improvement.
- *Project grants.* These involve the funding, for fixed or known periods, of specific projects. Project grants can include fellowships, scholarships, research grants, training grants, traineeships, experimental and demonstration grants, evaluation grants, planning grants, technical assistance grants, survey grants, and construction grants.
- *Direct payments for specific use.* Financial assistance is provided by the federal government directly to individuals, private firms, and other private institutions to encourage or subsidize a particular activity by conditioning the receipt of the assistance on a particular performance by the recipient. This does not include solicited contracts for the procurement of goods and services for the federal government.
- *Direct payments with unrestricted use.* Financial assistance is provided by the federal government directly to beneficiaries who satisfy federal eligibility requirements with no restrictions imposed on how the money is spent. Included are payments under retirement, pension, and compensation programs.
- *Direct loans.* Financial assistance is provided through the lending of federal monies for a specific period of time, with a reasonable expectation of repayment. Such loans may or may not require the payment of interest.
- *Guaranteed / insured loans.* Programs that the federal government makes an arrangement to indemnify a lender against part or all of any defaults by those responsible for the repayment of loans.
- *Insurance.* Financial assistance is provided to assure reimbursement for losses sustained under specified conditions. Coverage may be provided directly by the federal government or through a private carrier, and may or may not involve the payment of premiums.

- *Sale, exchange, or donation of property and goods.* These programs provide for the sale, exchange, or donation of federal real property, personal property, commodities, and other goods, including land, buildings, equipment, food, and drugs. This does not include the loan of, use of, or access to federal facilities or property.

Federal Cost-Reimbursement Contracts

5.14 The definition of federal awards also includes federal cost-reimbursement contracts. These are contracts with nonfederal entities to provide goods or services to the federal government. These contracts generally are governed by the Federal Acquisition Regulations (found in Part 41 of the *Code of Federal Regulations*) and the terms of the contracts.

Payment Methods

5.15 There are several distinct types of federal award payment methods. Awards may be provided to entities through reimbursement arrangements in which recipients bill grantors for costs as incurred. Some programs provide for advance payments. Other programs permit entities to draw cash as grant expenditures are incurred.

Defining the Entity to Be Audited

5.16 As discussed in chapter 6 of this guide, the single audit should cover the entire operations of the auditee or, at the option of the auditee, the audit may include a series of audits that cover departments, agencies, and other organizational units that expended or otherwise administered federal awards during the fiscal year, provided that each audit encompasses the financial statements and the schedule of expenditures of federal awards for each such department, agency, and organizational unit.

Relationship to Other Audit Requirements

5.17 An audit in accordance with Circular A-133 is deemed to be in lieu of any financial audit of federal awards that an entity is required to undergo under any other federal law or regulation. However, notwithstanding an audit in accordance with Circular A-133, federal agencies (including their Inspectors General or GAO) may conduct or arrange for additional audits (for example, financial audits, performance audits, evaluations, inspections, or reviews) that are necessary to carry out their responsibilities under federal law or regulation. Any additional audits should be planned and performed in such a way that build upon work performed by auditors. Circular A-133 requires a federal agency that conducts or contracts for additional audits to arrange for funding the full cost of such additional audits. Paragraph 5.32 discusses the federal agency option to request certain programs to be audited as major programs.

5.18 Circular A-133 states that the audit should be performed in accordance with *Government Auditing Standards*. Consequently, *Government Auditing Standards* applies not only to the audit of the financial statements but also to the Circular A-133 compliance audit. Furthermore, paragraph 1.22 of *Government Auditing Standards* notes that the standards apply to both financial statement audits and other types of financial audits, and additionally that a financial audit includes auditing compliance with regulations relating to federal award expenditures and other governmental financial assistance in conjunction with or as a byproduct of a financial statement audit. Therefore, compli-

ance with the general, fieldwork, and reporting standards in chapters 3–5 of *Government Auditing Standards* is required when conducting the Circular A-133 compliance audit. Those standards are discussed in chapter 2–4 of this guide. Areas that may require particular attention in the Circular A-133 compliance audit are auditor communication; audit documentation; procedures and reporting on abuse; the reporting of findings and related management views and planned corrective actions; and the reporting of certain matters in writing to officials of the audited entity. For example:

- Auditors should communicate information regarding the nature, timing, and extent of planned testing and reporting and the level of assurance under Circular A-133 to specified parties during the planning phase of the audit.
- Auditors have no responsibility to design the audit to detect abuse.¹⁰ However, if auditors become aware of indications of abuse that could be quantitatively or qualitatively material to the financial statements they should apply audit procedures specifically directed to ascertain the potential effect on the financial statements or other financial data significant to audit objectives. Chapter 3 of this guide discusses procedures relating to the evaluation of indications of abuse and chapters 9–10 of this guide discusses the nature of abuse as it relates to federal awards. Chapter 13 of this guide discusses the reporting of abuse involving federal awards.
- Auditors should obtain and report the views of responsible officials concerning findings, conclusions, and recommendations, as well as their planned corrective actions. As discussed in chapter 13 of this guide, the auditor may be able to refer to the auditee's corrective action plan required by Circular A-133 to satisfy that requirement for federal award-related findings. In addition, all audit findings, including federal award-related findings, are subject to the presentation requirements of *Government Auditing Standards*, as discussed in chapters 4 and 13 of this guide.
- Paragraph 5.16 of *Government Auditing Standards* states that the auditor should communicate to officials of the audited entity in writing violations of provisions of contracts or grant agreements or abuse that have an effect on the financial statements that is less than material but more than inconsequential. This communication may be done in a management letter. As discussed in chapter 13 of this guide, in an audit in accordance with Circular A-133, the auditor should evaluate such matters involving federal awards for the purpose of that communication based only on their consequence to the financial statements.

Frequency of Audits

5.19 Circular A-133 states that audits should be performed annually unless an auditee meets one of the following criteria that would allow it to have

¹⁰ Paragraph 4.12 of *Government Auditing Standards* describes *abuse* by stating that it does not necessarily involve fraud, violations of laws, regulations, or provisions of a contract or grant agreement. Abuse, it states, "involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances."

biennial audits (biennial audits should cover both years within the biennial period):

- State or local governments that are required by constitution or statute (in effect on January 1, 1987) to undergo audits less frequently than annually are permitted to have an audit in accordance with Circular A-133 performed biennially. This requirement should still be in effect for the biennial period under audit.
- NFPs that had biennial audits for all biennial periods ending between July 1, 1992, and January 1, 1995, are permitted to have an audit in accordance with Circular A-133 performed biennially.

Non-U.S.-Based Entities

5.20 Circular A-133 does not apply to non-U.S.-based entities expending federal awards received either directly as a recipient or indirectly as a sub-recipient. For example, if a federal agency provides financial assistance to an orphanage operated by a foreign government, Circular A-133 would not apply. However, Circular A-133 does apply to expenditures made by U.S.-based entities outside of the United States and by foreign branches of U.S.-based entities. For example, if a university based in the United States receives a federal award for travel and a three-month residence in a foreign country to conduct research, Circular A-133 would apply to the travel and the related research costs incurred in the foreign country. Another example would be a hospital that receives a federal award to perform medical research in a foreign country. If the research is conducted in the hospital's research laboratory based in the foreign country, the federal award would be subject to an audit in accordance with Circular A-133.

Reporting Matters

Audit Reports

5.21 Section 505 of Circular A-133 includes specific auditor reporting requirements. It states that the auditor's reports should include (a) an opinion (or disclaimer of opinion) concerning whether the financial statements are presented fairly in all material respects in conformity with GAAP and an opinion (or disclaimer of opinion) concerning whether the schedule of expenditures of Federal awards is presented fairly in all material respects in relation to the financial statements taken as a whole; (b) a report on internal control related to the financial statements and major programs; (c) a report on compliance with laws, regulations, and the provisions of contracts or grant agreements, which includes an opinion (or disclaimer of opinion) concerning whether the auditee complied with laws, regulations, and the provisions of contracts or grant agreements which could have a direct and material effect on each major program; and (d) a schedule of findings and questioned costs.¹¹ Chapters 13–14 of this guide discuss auditor reporting requirements for single and program-specific audits and include appendixes that illustrate schedules of findings and questioned costs and auditor's reports.

¹¹ Chapter 4 of this guide further discusses the auditor's reports under GAAS and *Government Auditing Standards* (that is, an opinion [or disclaimer of opinion] concerning whether the financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles and a report on internal control over financial reporting and compliance with laws, regulations, and provisions of contracts or grant agreements) and includes an appendix that illustrates those reports.

Timing of the Submission of the Report

5.22 The single audit should be completed and the reporting package described in (paragraph 5.38) including the auditor's reports, and the data collection form (described in paragraph 5.39) should be submitted by the auditee to the Federal Audit Clearinghouse (FAC). That submission should be completed within the earlier of 30 days after receipt of the auditor's reports or nine months after the end of the audit period, unless a longer period is agreed to in advance by the cognizant or oversight agency for audit. (Paragraphs 5.42–.45 discuss the definitions and responsibilities of cognizant and oversight agencies for audit.) Chapter 13 of this guide further describes the report submission requirements of Circular A-133.

Audit Follow-Up

5.23 Circular A-133 states that the auditor should follow up on prior audit findings, perform procedures to assess the reasonableness of the summary schedule of prior audit findings prepared by the auditee, and report a current-year audit finding when the auditor concludes that the summary schedule of prior audit findings materially misrepresents the status of any prior audit finding. Chapter 6 of this guide further discusses the auditor's responsibility for audit follow-up.

Auditor Selection and Audit Costs

Procurement of Audit Services and Restriction on Auditors Who Prepare Indirect Cost Proposals

5.24 Circular A-133 establishes guidance on the procurement of audit services, as well as guidance on the restrictions on the selection of auditors who also prepare the indirect cost proposal or cost allocation plan. As further discussed in chapter 6 of this guide, auditors who prepare the indirect cost proposal or cost allocation plan may not also be selected to perform an audit in accordance with Circular A-133 if the indirect costs recovered by the auditee during the prior year exceeded \$1 million.

Audit Costs

5.25 Circular A-133 provides guidance on whether the charging of audit costs to federal awards may be allowed. Unless prohibited by law, the costs of an audit in accordance with Circular A-133 are allowable charges to federal awards. The charges may be considered a direct cost or an allocated indirect cost, as determined in accordance with the provisions of applicable OMB Cost Principles Circulars, the Federal Acquisition Regulation, or other applicable cost principles or regulations. The costs of audits that are not conducted in accordance with Circular A-133 are unallowable. Furthermore, audit costs associated with an audit in accordance with Circular A-133 of entities that expend less than \$500,000 per year in federal awards are unallowable. However, this provision does not prohibit pass-through entities from charging federal awards for the costs of limited-scope audits to monitor its subrecipients. Chapter 12, "Audit Considerations of Federal Pass-Through Awards," of this guide further discusses the allowability of audit costs associated with limited-scope audits. With regard to the amount of audit cost that can be charged to a federal award, the Single Audit Act Amendments of 1996 states that in the absence of documentation demonstrating a higher actual cost, the percentage of the cost of

single audits charged to federal awards by an entity may not exceed the ratio of total federal awards expended to the entity's total expenditures for the fiscal year.

Basis for Determining When Federal Awards Are Expended

5.26 The determination of when an award is expended is based on when the activity related to the award occurs. In general, the activity pertains to events that require the auditee to comply with laws, regulations, and the provisions of contracts or grant agreements. Such events include the following:

- Expenditure or expense transactions associated with grants, cost reimbursement contracts, cooperative agreements, and direct appropriations
- The disbursement of funds passed through to subrecipients
- The use of loan proceeds under loan and loan-guarantee programs
- The receipt of property, including surplus property
- The receipt or use of program income
- The distribution or consumption of food commodities
- The disbursement of amounts entitling the auditee to an interest subsidy
- The period when insurance is in force

5.27 As further discussed in chapter 7 of this guide, Circular A-133 provides specific guidance on the basis for determining federal awards expended or the valuation for the following noncash items:

- Loans and loan guarantees, including those at institutions of higher education
- Prior loans and loan guarantees
- Endowment funds
- Free rent
- Noncash assistance, such as free rent, food stamps, food commodities, and donated property, including donated surplus property

Circular A-133 does not consider Medicare payments made to a nonfederal entity for patient care services to individuals to be federal awards. It also does not consider a state's Medicaid payments to a nonfederal entity for such services to be federal awards for purposes of the patient care service provider's audit unless the state requires it because the payments are on a cost-reimbursement basis. However, Circular A-133 considers the Medicaid payments made by a state to patient care service providers to be federal awards for purposes of the state's audit and reporting.

Subrecipient and Vendor Determinations

5.28 An auditee may be a recipient, a subrecipient, and a vendor. Federal awards expended as a recipient or a subrecipient are subject to audit under Circular A-133. Section 210 of Circular A-133 states that payments that vendors receive from a federal program for goods and services are not considered to be federal awards to the vendors and therefore not subject to an audit in

accordance with Circular A-133. Circular A-133 provides specific guidance on determining whether payments constitute a federal award or a payment for goods and services. Chapter 12 of this guide further discusses that guidance.

Major Program Determination

Risk-Based Approach

5.29 Circular A-133 states that the auditor should use a risk-based approach to determine which federal programs are major programs, which affects the scope of the audit. Circular A-133 places the responsibility for identifying major programs on the auditor, and provides criteria for the auditor to use in applying a risk-based approach. The auditor's determination of the programs to audit is based on an overall evaluation of the risks of noncompliance occurring that could be material to the individual federal programs. In evaluating risk, the auditor considers, among other things, the current and prior audit experience with the auditee, oversight by the federal agencies and pass-through entities, and the inherent risk of noncompliance of the federal programs, using a specific process established in the circular. Chapter 8 of this guide discusses that risk-based approach and the determination of major programs.

Low-Risk Auditee

5.30 Circular A-133 contains certain criteria for considering an auditee to be a low-risk auditee. A low-risk auditee is eligible for reduced audit coverage. *Low-risk auditee* is a term defined in Circular A-133 for the purpose of applying the percentage-of-coverage rule in the risk-based approach. (Chapter 8 of this guide discusses the low-risk auditee criteria and the percentage-of-coverage rule.) The term *low-risk auditee* does not imply or require the auditor to assess audit risk of noncompliance or any of its components as low for an entity that meets the Circular A-133 definition of a low-risk auditee.

Cluster of Programs

5.31 Circular A-133 defines a *cluster of programs* as a grouping of closely related federal programs that share common compliance requirements. The types of clusters of programs are R&D, SFA, and other clusters. *Other clusters* are defined by the OMB in the *Compliance Supplement* or are designated as such by a state for the federal awards the state provides to its subrecipients that meet the definition of a cluster of programs. When a state designates federal awards as an other cluster, it also should identify the federal awards included in the cluster and advise the subrecipients of the compliance requirements applicable to the cluster. A cluster of programs should be considered as one program for determining major programs and (with the exception of R&D) whether a program-specific audit may be elected.

Federal Agency Selection of Additional Major Programs

5.32 Section 215(c) of Circular A-133 permits a federal agency to request an auditee to have a particular federal program audited as a major program in lieu of the federal agency conducting or arranging for additional audits. To allow for planning, such requests should be made at least 180 days before the end of the fiscal year to be audited. After consultation with its auditor, the auditee should promptly respond to such a request by informing the federal agency whether the program would otherwise be audited as a major program

using the risk-based approach and, if not, the estimated incremental cost. The federal agency should then promptly confirm to the auditee whether it wants the program audited as a major program. If the program is to be audited as a major program based upon the federal agency's request, and the federal agency agrees to pay the full incremental costs, then the auditee should have the program audited as a major program. This approach also may be used by pass-through entities for a subrecipient.¹²

Auditee Responsibilities

Financial Statements and Schedule of Expenditures of Federal Awards

5.33 As discussed in chapter 6 of this guide, Circular A-133 states that auditees should prepare financial statements that reflect their financial position, the results of operations or changes in net assets, and, where appropriate, cash flows for the fiscal year audited. The financial statements should be for the same organizational unit and fiscal year that is chosen to meet the requirements of Circular A-133. However, organization-wide financial statements also may include departments, agencies, and other organizational units that have separate audits in accordance with Circular A-133 and prepare separate financial statements. As discussed in chapter 7 of this guide, Circular A-133 also states that auditees should prepare a schedule of expenditures of federal awards for the period covered by the financial statements.

Summary Schedule of Prior Audit Findings

5.34 In accordance with Circular A-133, the auditee should prepare a summary schedule of prior audit findings. The schedule should report the status of all audit findings included in the prior audit's schedule of findings and questioned costs relative to federal awards. It also should include audit findings reported in the prior audit's summary schedule of prior audit findings, except audit findings that have been corrected or are no longer valid. Chapter 13 of this guide further discusses that schedule.

Other Responsibilities

5.35 Circular A-133 establishes certain other responsibilities for auditees, including the following:

- Identifying in its accounts all federal awards received and expended and the federal programs under which they were received, including, as applicable, the CFDA title and number, the award number and year, the name of the federal agency, and the name of the pass-through entity
- Establishing and maintaining effective internal control over compliance for federal programs that provides reasonable assurance

¹² In addition, Section 520(c)(2) of Circular A-133 permits a federal awarding agency to request that a type A program for certain recipients not be considered low risk so that it would be audited as a major program. Further, Section 525(c)(2) of Circular A-133 states that federal agencies, with the concurrence of the OMB, may identify federal programs that are higher risk. That identification is provided by the OMB in the *OMB Circular A-133 Compliance Supplement (Compliance Supplement)*. See the further discussion of those provisions and the definition of type A programs in chapter 8, "Determination of Major Programs," of this guide.

that the auditee is managing federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its federal programs

- Complying with laws, regulations, and the provisions of contracts or grant agreements related to each of its federal programs
- Ensuring that the audits required by Circular A-133 are properly performed and submitted when due
- Following up and taking corrective action on audit findings (including the preparation of the previously discussed summary schedule of prior audit findings and a corrective action plan as discussed in paragraph 5.37); this guide recommends that corrective action should be initiated within six months after the receipt of the audit report and proceed as rapidly as possible

Responsibility for Compliance at the Financial Statement Level and for Internal Control Over Financial Reporting

5.36 Although not specifically stated in Circular A-133, the auditee also is responsible for complying with the requirements of laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on the financial statements and for establishing and maintaining effective internal control over financial reporting. *Government Auditing Standards* (which is required to be followed in a single audit) appendix I section A1.08 provides supplemental guidance stating that management of the audited entity is responsible for complying with applicable laws and regulations and implementing systems designed to achieve compliance with applicable laws and regulations.

Corrective Action Plan

5.37 At the completion of the audit, the auditee should prepare a corrective action plan to address each audit finding included in the current year's auditor's reports. Chapter 13 of this guide further discusses the corrective action plan.

Reporting Package

5.38 The auditee should submit to the FAC a reporting package that comprises the previously discussed financial statements and schedule of expenditures of federal awards, summary schedule of prior audit findings, auditor's reports, and corrective action plan. The auditee should submit the reporting package with the data collection form described in paragraph 5.39. These items are submitted electronically via the FAC's Internet Data Entry System. Chapter 13 of this guide describes the report submission process and related requirements of Circular A-133.

Data Collection Form

5.39 The auditee is required to submit a data collection form (SF-SAC) that provides information about the auditee, its federal programs, and the results of the audit. The auditor also is required to complete certain sections of the form and electronically certify an auditor statement provided on the form. Chapter 13 of this guide further discusses the data collection form and the submission process.

Federal Awarding Agency Responsibilities

5.40 Circular A-133 establishes certain responsibilities for federal agencies that provide federal awards to recipients, including the following:

- Identifying the federal awards made by informing each recipient of the CFDA title and number, the award name and number, the award year, and if the award is for R&D. When some of this information is not available, the federal agency should provide information necessary to clearly describe the federal award.
- Advising recipients of the requirements imposed on them by federal laws, regulations, and the provisions of contracts or grant agreements.
- Ensuring that audits are completed and reports are received in a timely manner and in accordance with the requirements of Circular A-133.
- Providing technical advice and counsel to auditees and auditors as requested.
- Issuing a management decision on audit findings within six months after receipt of the audit report and ensuring that the recipient takes appropriate and timely corrective action.
- Assigning a person to provide annual updates of the *Compliance Supplement* to the OMB.

Pass-Through Entity Responsibilities

5.41 Pass-through entities have many responsibilities that are similar to those of federal awarding agencies. Chapter 12 of this guide describes the responsibilities of pass-through entities.

Cognizant Agency for Audit

Definition

5.42 Circular A-133 defines the cognizant agency for audit as a federal agency designated to carry out the federal responsibilities with regard to a single audit. For recipients expending more than \$50 million a year in federal awards, the cognizant agency for audit will be the federal awarding agency that provides the predominant amount of direct funding to the recipient unless the OMB makes a specific cognizant agency for audit assignment. The determination of the predominant amount of direct funding is based on the direct federal awards expended by a recipient during its fiscal year ending in 2004, 2009, 2014, and every fifth year thereafter.¹³ For example, audit cognizance for periods ending in 2006–2010 will be determined based on the federal awards expended in 2004. Audit cognizance can be reassigned if both the old and the new federal agencies notify the auditee (and, if known, the auditor) of the change within 30 days of the reassignment. A recipient may have one federal agency responsible for audit cognizance and another federal agency responsible for the negotiation of indirect costs.

¹³ A current listing of cognizant agency for audit assignments is available at the Federal Audit Clearinghouse website at <http://harvester.census.gov/sac/dissemin/reports.html>. Under the heading "Select Specialized Report," enter the option titled "Cognizant Agency Report."

Responsibilities

5.43 Circular A-133 states that a cognizant agency for audit is responsible for

- providing technical audit advice and liaison to auditees and auditors.
- considering auditee requests for extensions to the report submission due date. The cognizant agency for audit may grant extensions for good cause.
- obtaining or conducting quality control reviews of selected audits made by nonfederal auditors and providing the results, when appropriate, to other interested organizations.
- promptly informing other affected federal agencies and appropriate federal law enforcement officials of any direct reporting by the auditee or its auditor of irregularities or illegal acts, as required by *Government Auditing Standards* or laws and regulations.
- advising the auditor and, where appropriate, the auditee of any deficiencies found in the audits when the deficiencies require corrective action by the auditor. When advised of deficiencies, the auditee should work with the auditor to take corrective action. If corrective action is not taken, the cognizant agency for audit should notify the auditor, the auditee, and the applicable federal awarding agencies and pass-through entities of the facts and make recommendations for follow-up action. Major inadequacies or repeated substandard performance by auditors will be referred to appropriate state licensing agencies and professional bodies for disciplinary action.
- coordinating, to the extent practicable, the audits or reviews made by or for federal agencies that are in addition to audits under Circular A-133, so that the additional audits or reviews build upon the audits performed in accordance with Circular A-133.
- coordinating a management decision for audit findings that affect the federal programs of more than one federal agency.
- coordinating the audit work and reporting responsibilities among auditors, to achieve the most cost-effective audit.

For biennial audits, the cognizant agency for audit also is responsible for considering auditee requests to qualify as a low-risk auditee.

Oversight Agency for Audit

Definition

5.44 An auditee that does not have a designated cognizant agency for audit (that is, one that expends \$50 million or less in federal awards) will have an oversight agency for audit. Circular A-133 defines the oversight agency for audit as a federal awarding agency that provides the predominant amount of direct funding to a recipient not assigned a cognizant agency for audit as previously discussed. When there is no direct funding, the federal agency with the predominant indirect funding should assume the oversight responsibilities.

An oversight agency for audit may reassign oversight to another federal agency that provides substantial funding and agrees to be the oversight agency for audit. Within 30 days after reassignment, both the old and the new oversight agency for audit should notify the auditee (and, if known, the auditor) of the reassignment.

Responsibilities

5.45 Circular A-133 describes the duties of oversight agencies for audit. The responsibilities of an oversight agency for audit are not as broad as those of a cognizant agency for audit. An oversight agency's primary responsibility is to provide technical advice to auditees and auditors when it is requested. However, an oversight agency may assume all or some of the responsibilities normally performed by a cognizant agency for audit.

Program-Specific Audits

5.46 Circular A-133 provides general guidance on performing program-specific audits. In many cases, a program-specific audit guide will be available from the federal agency's Office of Inspector General. The audit guide will provide specific guidance to the auditor with respect to internal control, compliance requirements, suggested audit procedures, and audit reporting requirements. When a program-specific audit guide is not available, the auditee and auditor have basically the same responsibilities for the federal program as they would have for an audit of a major program in a single audit. Chapter 14 of this guide further discusses program-specific audits.

OMB Circular A-133 Compliance Supplement

5.47 Circular A-133 states that the auditor should determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements (compliance requirements) that may have a direct and material effect on each of its major programs. The principal tool for this purpose is the *Compliance Supplement*. Chapter 10 of this guide further discusses compliance requirements and the *Compliance Supplement*.

5.48 The *Compliance Supplement* is based on the requirements of the Single Audit Act Amendments of 1996 and Circular A-133, which provide for the issuance of a compliance supplement to assist auditors in performing the required audits. The *Compliance Supplement*, which is updated annually,¹⁴ serves to identify existing types of compliance requirements that the federal government expects to be considered as part of an audit in accordance with the Single Audit Act Amendments of 1996 and Circular A-133:

- For the programs it includes, the *Compliance Supplement* provides a source of information for auditors to understand the federal program's objectives, procedures, and types of compliance requirements relevant to the audit, as well as the audit objectives and suggested audit procedures for determining compliance with these requirements.

¹⁴ The *Compliance Supplement* is available on the OMB's website at www.whitehouse.gov/omb/grants_circulars or for sale from the Government Printing Office by calling (202) 512-1800.

- For programs not listed in the *Compliance Supplement*, the auditor should follow *Compliance Supplement* Part 7, "Guidance for Auditing Programs Not Included in This Compliance Supplement," which instructs the auditor to use the types of compliance requirements (for example, cash management, reporting, allowable costs/cost principles, activities allowed or unallowed, eligibility, and matching, level of effort, and earmarking) contained in the *Compliance Supplement* as guidance for identifying the types of compliance requirements to test, and to determine the requirements governing the federal program by reviewing the provisions of contracts and grant agreements and the laws and regulations referred to in such contracts and grant agreements.

American Recovery and Reinvestment Act Considerations^{||}

5.49 The Recovery Act, which imposes new transparency and accountability requirements on both federal awarding agencies and their recipients, has significant implications for audits performed under Circular A-133. The single audit process is a key mechanism in achieving specific accountability objectives.

5.50 The OMB is responsible for developing government-wide guidance for carrying out programs and activities enacted in the Recovery Act and is issuing guidance directed at the federal agencies, recipients of federal awards, and auditors. To date, OMB Recovery Act guidance has been issued in several forms. Guidance issued by the OMB for federal agencies and recipients has generally been released through memorandums and Recovery Act frequently asked questions that can be accessed on the OMB website at www.whitehouse.gov/omb/recovery_default. This guidance provided for federal agencies and recipients is also informative for auditors. Auditors are advised to check the OMB website frequently to learn about new and updated guidance provided by the OMB.

5.51 The *Compliance Supplement* has been the primary mechanism that the OMB has used to provide Recovery Act requirements and guidance to auditors. In addition to the annual edition of the *Compliance Supplement*, the OMB may issue *Compliance Supplement* addendums during the year to update or provide new Recovery Act guidance. The 2010 *Compliance Supplement* includes Recovery Act guidance in the main sections of the supplement (parts 1–7) and in appendix 7, "Other OMB Circular A-133 Advisories." Auditors are advised to review the Recovery Act sections of the 2010 *Compliance Supplement* to determine the effects on Circular A-133 audits, as well as to periodically check the OMB website at www.whitehouse.gov/omb/grants_circulars/ for any addendum

^{||} Information in this guide related to the American Recovery and Reinvestment Act of 2009 (Recovery Act) is based upon the latest information available at the time of this writing. However, this information is subject to change because guidance from the OMB is being issued and updated on an ongoing basis. It is important for recipients of Recovery Act funding, and their auditors, to monitor the guidance issued. For the latest OMB guidance, go to the OMB website at www.whitehouse.gov/omb/recovery_default. Information can also be found at the Recovery Act Resource Center on the Governmental Audit Quality Center website, which is open to the public at www.aicpa.org/INTERESTAREAS/GOVERNMENTALAUDITQUALITY/RESOURCES/RECOVERYACTRESOURCECENTER/Pages/default.aspx and at the U.S. Government's official Recovery Act website at www.recovery.gov.

that might be issued. Auditors performing 2009 single audits can also find the 2009 *Compliance Supplement* and a related addendum, both of which included Recovery Act information for 2009 audits, at www.whitehouse.gov/omb/grants_circulars/. The AICPA Governmental Audit Quality Center Recovery Act Resource Center, which is open to the general public, might also serve as a useful resource for auditors on Recovery Act matters. It can be found at www.aicpa.org/INTERESTAREAS/GOVERNMENTALAUDITQUALITY/RESOURCES/Pages/default.aspx.

Chapter 6

Planning Considerations of Circular A-133

Note: The audit required by the Single Audit Act Amendments of 1996 and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133), should be performed in accordance with *Government Auditing Standards*. Part I, "Government Auditing Standards Audits," (chapters 2–4 of this guide) discusses financial statement audits under generally accepted auditing standards (GAAS) and *Government Auditing Standards*. The guidance in parts I and II, "Circular A-133 Audits," (chapters 5–14 of this guide) is applicable for those auditors performing an audit under the Single Audit Act Amendments of 1996 and Circular A-133.

Information related to the American Recovery and Reinvestment Act of 2009 (Recovery Act) can be found in a section located at the end of each chapter in part II of this guide. See the section titled "American Recovery and Reinvestment Act Considerations" beginning at paragraph 6.70 in this chapter. See also the preface section titled "Impact of the American Recovery and Reinvestment Act of 2009 on Single Audits."

Introduction

6.01 In planning an audit to meet the requirements of Circular A-133, the auditor needs to consider several matters in addition to those ordinarily associated with an audit of financial statements in accordance with GAAS and *Government Auditing Standards*. This chapter discusses additional planning considerations in a single audit conducted in accordance with Circular A-133. Many of these planning considerations also are applicable in program-specific audits, which are discussed in chapter 14, "Program-Specific Audits," of this guide.

6.02 Chapter 2, "Planning Considerations of *Government Auditing Standards*," of this guide discusses matters that are relevant to the planning of a financial statement audit. The rest of this chapter discusses the following additional or expanded matters relevant to the planning of a single audit:

- Adapting and applying applicable auditing standards to a Circular A-133 compliance audit
- Identifying supplementary audit requirements
- Establishing an understanding with the auditee
- Audit documentation
- Supplementary audit requirements of the Single Audit Act and Circular A-133 regarding audit documentation access and audit follow-up
- Financial statement audit considerations
- Defining the entity to be audited

- Determining the audit period
- Initial-year audit considerations
- Timing of the completion of the audit and report submission deadlines
- Determining the major programs to be audited
- Identifying applicable compliance requirements
- Audit risk of noncompliance considerations
- Assessing the risks of material noncompliance
- Audit materiality considerations
- Developing an efficient audit approach
- Joint audits and reliance on others
- Existence of an internal audit function
- Communications with the cognizant or oversight agency for audit and others
- Understanding the applicable state and local compliance and reporting requirements
- Desk reviews and on-site reviews
- Restriction on the auditor's preparation of indirect cost proposals

Adapting and Applying Applicable Auditing Standards to a Circular A-133 Compliance Audit

6.03 Single audits are required to be performed in accordance with *Government Auditing Standards*, which incorporate the fieldwork and reporting standards of GAAS and the related Statements on Auditing Standards (SASs) issued by the AICPA. SAS No. 117, *Compliance Audits* (AICPA, *Professional Standards*, vol. 1, AU sec. 801), addresses a compliance audit, which is a component of a single audit. It is applicable when an auditor is engaged, or required by law or regulation, to perform a compliance audit in accordance with all of the following:

- Generally accepted auditing standards
- The standards for financial audits under *Government Auditing Standards*
- A governmental audit requirement that requires the auditor to express an opinion on compliance

6.04 SAS No. 117 defines a *governmental audit requirement* as a government requirement established by law, regulation, rule, or provision of contracts or grant agreements requiring that an entity undergo an audit of its compliance with applicable compliance requirements¹ related to one or more government

¹ Statement on Auditing Standards (SAS) No. 117, *Compliance Audits* (AICPA, *Professional Standards*, vol. 1, AU sec. 801), defines *applicable compliance requirements* as the compliance requirements that are subject to the compliance audit. Paragraph .500(d) of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133), states that the auditor should determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that may have a direct and material effect on each of its major programs. Therefore, in a Circular A-133 compliance audit, the direct and material compliance requirements are those that are subject to audit. Accordingly, for the

(continued)

programs that the entity administers. The SAS also identifies Circular A-133 as an example of a governmental audit requirement that meets the preceding criteria. Therefore, SAS No. 117 is applicable to and provides requirements and guidance for auditors conducting an audit in accordance with Circular A-133. Chapters 9–10 of this guide provide additional information and guidance related to SAS No. 117. Part I of this guide provides information and guidance for an audit performed under *Government Auditing Standards*.

6.05 AU sections 100–700 and 900, *Special Reports of the Committee on Auditing Procedure* (AICPA, *Professional Standards*, vol. 1), address audits of financial statements, as well as other kinds of engagements. When performing a Circular A-133 compliance audit, the auditor, using professional judgment, should adapt and apply these AU sections of AICPA *Professional Standards* to the objectives of the compliance audit, except for those AU sections identified as not applicable to compliance audits in the appendix to SAS No. 117.²

6.06 AU sections often identify audit procedures and contain examples that are specific to a financial statement audit. However, SAS No. 117 states that the auditor is not required, in planning and performing the compliance audit, to make a literal translation of each procedure that might be performed in a financial statement audit, but rather to obtain sufficient appropriate audit evidence to support the auditor's opinion on compliance. SAS No. 117 also clarifies that the auditor is not expected to adapt or apply all such procedures to the compliance audit, only those that, in the auditor's professional judgment, are relevant and necessary to meet the objectives of the compliance audit. Some AU sections can be adapted with relative ease, for example, by replacing the word *misstatement* with *noncompliance*. However, other AU sections are more difficult to adapt without additional modification. For that reason, SAS No. 117 provides more specific guidance on how to adapt certain AU sections to a compliance audit. This guide also provides information on how an auditor may adapt certain AU sections to a compliance audit.

Identifying Supplementary Audit Requirements

6.07 In a Circular A-133 compliance audit, the auditor should determine the additional audit requirements that are supplementary to GAAS and *Government Auditing Standards* and perform procedures to address those requirements. Part II of this guide provides information to assist the auditor in addressing the supplementary audit requirements of Circular A-133. In instances in which the audit guidance provided by a governmental agency for the performance of a compliance audit has not been updated, or otherwise conflicts with current guidance, the auditor should comply with the most current applicable GAAS and *Government Auditing Standards* instead of the outdated guidance.

(footnote continued)

purpose of adapting SAS No. 117 to a Circular A-133 compliance audit, the term *applicable compliance requirements* has been replaced by *direct and material compliance requirements* in this guide except when directly citing content from SAS No. 117.

² The appendix to SAS No. 117 titled "AU Sections That Are Not Applicable to Compliance Audits" states that certain AU sections are identified as not applicable to a compliance audit. They are identified as such either because they (a) are not relevant to a compliance audit environment, (b) the procedures and guidance would not contribute to meeting the objects of a compliance audit, or (c) the subject matter is specifically covered in SAS No. 117.

Establishing an Understanding With the Auditee

6.08 As discussed in chapter 2 of this guide, AU section 311, *Planning and Supervision* (AICPA, *Professional Standards*, vol. 1), states that the auditor should establish an understanding with the auditee regarding the services to be performed for each engagement. That understanding generally contains the information found in paragraph .09 of AU section 311 and should be communicated in the form of an engagement letter. In addition to the matters communicated as part of the financial statement audit, as discussed in chapter 2 of this guide, *Government Auditing Standards* states that the auditor should include information regarding the planned work and level of assurance related to internal control over financial reporting and compliance with laws, regulations, and provisions of grants and contracts. Therefore, because the Circular A-133 compliance audit is performed under *Government Auditing Standards*, the communication should include the planned work and level of assurance related to internal control over compliance and compliance with laws, regulations, and provisions of contracts or grant agreements necessary for an audit in accordance with Circular A-133. Examples of the type of information that might be included in the communication when performing an audit in accordance with Circular A-133 are as follows:

- A statement that the supplemental schedule(s) to be considered in the audit include the schedule of expenditures of federal awards
- The objective of an audit in accordance with Circular A-133
- A description of the additional reports required by Circular A-133 that the auditor is expected to prepare and issue, including any limitation on their use
- A description of management's responsibility for (a) preparation of the schedule of expenditures of federal awards in accordance with Circular A-133 requirements; (b) internal control over compliance; (c) compliance with laws, regulations, and the provisions of contracts and grant agreements; (d) following up and taking corrective action on audit findings, including the preparation of a summary schedule of prior audit findings and a corrective action plan; and (e) submitting the reporting package and data collection form
- A statement that management will make the auditor aware of significant vendor relationships where the vendor is responsible for program compliance (so that the auditor can determine if additional procedures on vendor records will be necessary—see chapter 12, "Audit Considerations of Federal Pass-Through Awards," of this guide)
- A description of the auditor's responsibility in a compliance audit of major programs under Circular A-133, including the determination of major programs, the consideration of internal control over compliance, and reporting responsibilities
- A statement that the parties to whom audit documentation will be made available upon request include federal agencies and the U.S. Government Accountability Office (GAO)

In addition, paragraph 37 of SAS No. 117 states that the auditor should communicate to those charged with governance the auditor's responsibilities under

GAAS, *Government Auditing Standards*, and the governmental audit requirement (for example, Circular A-133) an overview of the planned scope and timing of the compliance audit and significant findings from the compliance audit.

Audit Documentation

6.09 Audit documentation requirements and guidance, as it relates to the beginning stages of an audit, is in AU section 314, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AICPA, *Professional Standards*, vol. 1). As part of the fieldwork guidance of GAAS, this guidance is applicable to all audits performed under *Government Auditing Standards*, including Circular A-133 compliance audits. Paragraph .123 of AU section 314 states that generally the more complex the entity and its environment, including its internal control, and the more extensive the audit procedures performed by the auditor, the more extensively the auditor should document his or her work. Although the manner in which these matters are documented is determined using the auditor's professional judgment, AU section 339, *Audit Documentation* (AICPA, *Professional Standards*, vol. 1), provides requirements and guidance. Paragraph .03 of AU section 339 states that the auditor must prepare audit documentation in connection with each engagement in sufficient detail to provide a clear understanding of the work performed (including the nature, timing, extent, and results of audit procedures performed), the audit evidence obtained and its source, and the conclusions reached. Audit documentation is important because it provides the principal support that the audit was performed in accordance with GAAS, *Government Auditing Standards* and Circular A-133, and provides the principal support for each of the opinions issued.

6.10 Furthermore, SAS No. 117 contains requirements and guidance related to documentation of audit procedures performed in a compliance audit. One of these requirements is that the auditor should document the risk assessment procedures performed, including those related to gaining an understanding of internal control over compliance. See chapter 10, "Compliance Auditing Applicable to Major Programs," for more information regarding documentation requirements in a Circular A-133 compliance audit.

Supplementary Audit Requirements of the Single Audit Act and Circular A-133 Regarding Audit Documentation Access and Audit Follow-Up³

Audit Documentation Access and Retention

6.11 Based on language in the Single Audit Act Amendments of 1996, Section 515(b) of Circular A-133 states that audit working papers (referred to in this guide as *audit documentation*) "shall be made available upon request to the cognizant or oversight agency for audit or its designee, a Federal agency providing direct or indirect funding, or GAO at the completion of the audit, as part of a quality review, to resolve audit findings, or to carry out oversight responsibilities. . . ." It also states that access to the audit documentation includes

³ Chapter 2, "Planning Considerations of *Government Auditing Standards*," of this guide discusses the *Government Auditing Standards* audit documentation access and follow-up requirements.

the right to obtain copies. The Senate Committee report that accompanied the Single Audit Act Amendments of 1996 stated that federal agencies should be judicious in the exercise of this authority and that it was the committee's intent that the federal agencies recognize that audit documentation may contain trade secrets and confidential commercial and financial information and should treat such information as confidential under the Freedom of Information Act (U.S. Code title 5, Section 552). Interpretation No. 1, "Providing Access to or Copies of Audit Documentation to a Regulator," of AU section 339 (AICPA, *Professional Standards*, vol. 1, AU sec. 9339 par. .01–.15), contains guidance for when a regulator requests access to audit documentation pursuant to law, regulation, or audit contract.

6.12 Circular A-133 states that auditors should retain audit documentation and reports for a minimum of three years after the date of issuance of the auditor's report to the auditee, unless the auditor is notified in writing by the cognizant agency for audit, oversight agency for audit, or pass-through entity to extend the retention period. However, paragraph .32 of AU section 339 states that audit documentation should be retained for at least five years from the report release date. The AU section 339 documentation retention guidance⁴ should be followed for a Circular A-133 compliance audit because the five year retention period is longer than the three year period defined in Circular A-133. When the auditor is aware that the federal awarding agency, pass-through entity, or auditee is contesting an audit finding, the auditor should contact the parties contesting the audit finding for guidance before the destruction of the audit documentation and reports.

Audit Follow-Up

6.13 Circular A-133 states that the auditor should follow up on prior audit findings, perform procedures to assess the reasonableness of the summary schedule of prior audit findings prepared by the auditee, and report, as a current-year audit finding, when the auditor concludes that the summary schedule of prior audit findings materially misrepresents the status of any prior audit finding. Chapters 10 and 13, "Auditor Reporting Requirements and Other Communication Considerations in a Single Audit," of this guide further discuss the auditor's responsibility for audit follow-up.

Financial Statement Audit Considerations

6.14 Circular A-133 states that auditees should prepare financial statements that reflect their financial position, results of operations or changes in net assets, and, where appropriate, cash flows for the fiscal year audited. The financial statements should be for the same organizational unit and fiscal year that is chosen to meet the requirements of Circular A-133. However, organization-wide financial statements also may include departments, agencies, and other organizational units that have separate audits and prepare separate financial statements (see paragraph 6.17). Circular A-133 also states that auditees should prepare a schedule of expenditures of federal awards for the period covered by the financial statements. Chapter 7, "Schedule of Expenditures of Federal Awards," of this guide discusses the schedule of expenditures of federal awards.

⁴ Some state boards of accountancy prescribe longer document retention periods. Documents should be retained for the longest of any required documentation retention period.

6.15 Circular A-133 does not prescribe the basis of accounting that auditees use to prepare their financial statements. However, auditees should disclose the basis of accounting and significant accounting policies used in preparing the financial statements. Circular A-133 states that auditees should be able to identify in their accounts all federal awards expended and the federal programs under which they were received. Generally, auditees evidence the ability to identify federal awards expended by preparing a reconciliation of amounts presented in the financial statements to the amounts and programs in the schedule of expenditures of federal awards.

6.16 Circular A-133 states that the auditor should issue an opinion (or a disclaimer of opinion) as to whether the financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles (GAAP).⁵ (Chapters 4, "Auditor Reporting Requirements and Other Communication Considerations of *Government Auditing Standards*," and 13 of this guide provide guidance on reporting on the auditee's financial statements.) If the auditee prepares its financial statements in conformity with a comprehensive basis of accounting other than GAAP,⁶ the auditor still is required to express or disclaim an opinion. AU section 623, *Special Reports* (AICPA, *Professional Standards*, vol. 1), contains relevant requirements and guidance. The financial statements also should be audited in accordance with *Government Auditing Standards*. (See the note at the beginning of this chapter.) Circular A-133 does not impose on the financial statement audit any additional audit requirements beyond *Government Auditing Standards*.

Defining the Entity to Be Audited

6.17 One of the initial tasks during the planning process of a single audit is determining whether management has properly defined the entity to be audited. Circular A-133 states that single audits should cover the entire operations of the auditee. However, Circular A-133 provides auditees the option to meet the audit requirements of the circular through a series of audits that cover an auditee's departments, agencies, and other organizational units

⁵ As explained in the AICPA Audit and Accounting Guide *State and Local Governments*, the auditor generally expresses or disclaims an opinion on a government's basic financial statements by providing an opinion or disclaimer of opinion on each opinion unit required to be presented in those financial statements. In addition, the auditor may provide opinions or disclaimers of opinion on additional opinion units if engaged to set the scope of the audit and assess materiality at a more detailed level than by the opinion units required for the basic financial statements. Throughout this guide, the use of the singular terms *opinion* and *disclaimer of opinion* encompasses the multiple opinions and disclaimers of opinion that generally will be provided on a government's financial statements.

⁶ Paragraph .04 of AU section 623, *Special Reports* (AICPA, *Professional Standards*, vol. 1), defines the comprehensive bases of accounting other than generally accepted accounting principles, known as *other comprehensive bases of accounting* (OCBOA), and establishes requirements for reporting on audits of OCBOA financial statements. Interpretation No. 14, "Evaluating the Adequacy of Disclosure and Presentation in Financial Statements Prepared in Conformity With an Other Comprehensive Basis of Accounting (OCBOA)," and No. 15, "Auditor Reports on Regulatory Accounting or Presentation When the Regulated Entity Distributes the Financial Statements to Parties Other Than the Regulatory Agency Either Voluntarily or Upon Specific Request," of AU section 623 (AICPA, *Professional Standards*, vol. 1, AU sec. 9623 par. .90–.98), provide additional guidance on reporting on audits of OCBOA financial statements. The AICPA Audit and Accounting Guide *State and Local Governments* discusses the application of AU section 623 and those two interpretations to state and local governmental financial statements. That guide and paragraph .97 of Interpretation No. 15 also provide illustrative auditor's reports on OCBOA financial statements. In addition, in the AICPA's Practice Aid Series, two publications—*Applying OCBOA in State and Local Governmental Financial Statements* and *Preparing and Reporting on Cash- and Tax-Basis Financial Statements*—provide nonauthoritative guidance on preparing and reporting on OCBOA financial statements.

that expended or otherwise administered federal awards during a fiscal year. If an auditee elects this option, separate financial statements and a schedule of expenditures of federal awards should be prepared for each such department, agency, or other organizational unit. In these circumstances, an auditee's organization-wide financial statements also may include departments, agencies, or other organizational units that have separate audits and prepare separate financial statements. For example, if a local government has its school districts audited separately, it would be acceptable for the local government's financial statements to include the school districts, even though the school districts were not included in the local government's Circular A-133 audit, because a separate Circular A-133 audit was conducted on the school districts. However, if separate financial statements were not prepared for the school districts, it would be unacceptable for a separate Circular A-133 audit to be conducted on the school districts (that is, the local government's organization-wide financial statements could not be used as a substitute for separate financial statements for the school districts). Chapter 13 of this guide discusses auditor reporting in situations in which (a) the implementation regulations of federal awarding agencies⁷ define the entity to be audited differently than does GAAP and (b) the audit of federal awards does not encompass the entirety of the auditee's operations expending federal awards.

Determining the Audit Period

Fiscal Year and Program Period May Differ

6.18 An audit performed in accordance with Circular A-133 should cover the auditee's financial transactions (including transactions related to federal awards) for its fiscal year (or a two-year period, if allowed by Circular A-133), which is not necessarily the same as the period of the program being funded. (Chapter 5, "Overview of the Single Audit Act, Circular A-133, and the *Compliance Supplement*," of this guide discusses the allowability of biennial audits). Thus, the audit might include only a part of the transactions of a federal award, because some transactions may not occur within the period covered by the audit.

Stub Periods

6.19 Stub periods may occur when an auditee converts from a program-specific audit to a single audit or changes audit periods. One example would be a community college with a September 30 year end that previously had a program-specific audit and is now converting to a single audit. The prior program-specific audits were performed based on a June 30 award year. The first single audit will be for the year ending September 30. This would leave the community college with an unaudited stub period of July 1 to September 30. The audit requirements of Circular A-133 still apply to federal expenditures during the stub period and are generally met through a separate audit of the stub period or by including the expenditures of the stub period in the scope of the following period's single audit. Either way, the threshold for audit requirement is still \$500,000 in federal expenditures for the period. Auditees or their auditors can contact the cognizant or oversight agency for audit or the pass-through entity for advice on how stub periods can be addressed.

⁷ Certain federal agencies, such as the U.S. Department of Housing and Urban Development, have specifically defined the level of the entity subject to audit.

Initial-Year Audit Considerations

Preceding Period Audited by Another Auditor

6.20 Whenever an auditor is considering accepting an engagement in which the federal awards of the preceding period were audited by another auditor, the guidance in AU section 315, *Communications Between Predecessor and Successor Auditors* (AICPA, *Professional Standards*, vol. 1), contains relevant information. It provides guidance on communications between predecessor and successor auditors when a change in auditors is in process or has taken place, and it includes illustrative letters. AU section 315 also provides communications guidance when possible misstatements are discovered in financial statements reported on by a predecessor auditor.

Factors to Consider Under the Risk-Based Approach⁸

6.21 When the engagement includes the selection of major programs using the risk-based approach defined in Circular A-133, an auditor accepting, or contemplating accepting, an engagement might consider gathering information about the following:

- Federal awards expended by federal programs
- Prior-period findings and questioned costs (including the corrective action plan and management decision related to the findings and summary schedule of prior audit findings)
- Whether a predecessor auditor used the exception that allows deviation from the risk-based approach during the last three years, as discussed in chapter 8, "Determination of Major Programs," of this guide
- Correspondence from program officials indicating potential problems
- New programs
- Changes to programs
- Amount of funding passed through to subrecipients by individual federal programs
- Extent to which computer processing is used to administer federal programs
- Federal programs audited as major programs for the last two years

Timing of the Completion of the Audit and Report Submission Deadlines

6.22 When planning the timing of the single audit, auditors should consider the Circular A-133 requirement that the audit be completed and the data collection form and reporting package be submitted to the federal clearinghouse within a certain time period. Chapters 5 and 13 of this guide discuss the reporting package and the timing requirements for submission.

⁸ See the discussion in chapter 8, "Determination of Major Programs," for more information on the risk-based approach to selection major programs.

Determining the Major Programs to Be Audited

6.23 As discussed in chapter 5 of this guide, Circular A-133 includes a supplementary audit requirement that states that the auditor should use a risk-based approach to determine which federal programs are major programs. This determination will affect the scope of the Circular A-133 compliance audit and the compliance requirements to be tested. Chapter 8 of this guide discusses the determination of major programs and an exception available for certain first year audits that allows deviation from the use of risk criteria in determining major programs.

Identifying Applicable Compliance Requirements⁹

6.24 As noted in SAS No. 117, a compliance audit is based on the premise that management is responsible for identifying the entity's government programs and understanding and complying with the compliance requirements. As part of the compliance audit, the auditor should determine which of those government programs and compliance requirements to test in accordance with Circular A-133.

6.25 SAS No. 117 defines *applicable compliance requirements* as compliance requirements that are subject to a compliance audit. SAS No. 117 also states that some governmental audit requirements provide a framework for the auditor to determine the applicable compliance requirements and cites the *OMB Circular A-133 Compliance Supplement (Compliance Supplement)* as such a framework in a Circular A-133 compliance audit. Therefore, in a Circular A-133 compliance audit, the applicable compliance requirements are those that may have a direct and material effect on each major program (direct and material compliance requirements). Further, the *Compliance Supplement* is the primary source for identifying compliance requirements for federal programs, and the auditor, using professional judgment, determines which of the 14 types of compliance requirements may have a direct and material effect on each major program. These direct and material compliance requirements are tested as part of the compliance audit. A program specific audit guide issued by a grantor agency may be another source for identifying applicable compliance requirements. For programs not included in the *Compliance Supplement*, Part 7 of that document instructs auditors to, among other things, review the federal award document and referenced laws and regulations applicable to the program and the Catalog of Federal Domestic Assistance. Chapter 10 of this guide further discusses the use of the *Compliance Supplement* to identify direct and material compliance requirements.

Audit Risk of Noncompliance Considerations

6.26 The requirements and guidance related to the auditor's consideration of audit risk of noncompliance and materiality when planning and performing a single audit is found in SAS No. 117 and AU section 312, *Audit Risk and Materiality in Conducting an Audit* (AICPA, *Professional Standards*, vol. 1). Audit risk of noncompliance and materiality, among other matters, need to be considered together for each major program being tested as well as for each

⁹ See footnote 1.

direct and material compliance requirement in determining the nature, timing, and extent of audit procedures and in evaluating the results of those procedures.

6.27 As discussed in chapter 2 of this guide, in a financial statement audit, GAAS and *Government Auditing Standards* require the auditor to design the audit to provide reasonable assurance of detecting material misstatements resulting from noncompliance with laws, regulations, and provisions of contracts or grant agreements that have a direct and material effect on the determination of financial statement amounts.¹⁰

6.28 Furthermore, Circular A-133 states that the auditor should determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that may have a direct and material effect on each of its major programs. Therefore, in developing an audit plan for a single audit, the auditor should assess not only the risk that noncompliance may cause the financial statements to contain a material misstatement, but also the risk that noncompliance may have a material effect on each major program.

Components of Audit Risk of Noncompliance

6.29 *Audit risk of noncompliance* is the risk that the auditor expresses an inappropriate audit opinion on the entity's compliance when material noncompliance exists. It is a function of the risks of material noncompliance and detection risk of noncompliance.

Risk of Material Noncompliance

6.30 The risk of material noncompliance is the risk that material noncompliance exists before the audit. It consists of inherent risk of noncompliance and control risk of noncompliance.¹¹ For the purposes of a single audit and the auditor's opinion on compliance, these risk components are defined as follows:¹²

inherent risk of noncompliance. The susceptibility of a major program's compliance requirement to noncompliance that could be material, either individually or when aggregated with other instances of noncompliance, before consideration of any related controls over compliance.

control risk of noncompliance. The risk that noncompliance with a compliance requirement that could occur and that could be material to a major program, either individually or when aggregated with other instances of noncompliance, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control over compliance.

¹⁰ Paragraph 4.28 of *Government Auditing Standards* defines the term *illegal acts* as violations of laws and regulations. As indicated in chapter 3, "Financial Statement Audit Considerations of *Government Auditing Standards*," of this guide, it generally has been interpreted that the term *laws and regulations* implicitly includes provisions of contracts or grant agreements. This guide sometimes collectively refers to laws, regulations, and provisions of contracts and grant agreements as *compliance requirements* and to illegal acts and violations of provisions of contracts or grant agreements as *noncompliance* or *instances of noncompliance*.

¹¹ In part II of this guide, the term *control risk of noncompliance* is used in order to be consistent with the term as used and defined in SAS No. 117. The term *control risk* is used only when directly citing Circular A-133. Both terms have the same meaning.

¹² The definitions of *inherent risk of noncompliance*, *control risk of noncompliance*, and *detection risk of noncompliance* have been modified from the definition found in SAS No. 117 to reflect terminology used in a Circular A-133 compliance audit.

Detection Risk of Noncompliance

6.31 Detection risk of noncompliance is managed by the auditor's response to the risks of material noncompliance. It is defined as follows:

detection risk of noncompliance. The risk that the procedures performed by the auditor to reduce audit risk of noncompliance to an acceptably low level will not detect noncompliance that exists and that could be material to a major program, either individually or when aggregated with other instances of noncompliance.

Performing Risk Assessment Procedures

6.32 For each of the major programs and direct and material compliance requirements selected for testing, the auditor should perform risk assessment procedures to obtain a sufficient understanding of the direct and material compliance requirements and the entity's internal control over compliance with those compliance requirements. Obtaining an understanding of the major program, the direct and material compliance requirements, and the entity's internal control over compliance establishes a frame of reference within which the auditor plans the compliance audit and exercises professional judgment about assessing the risks of material noncompliance and responding to those risks throughout the compliance audit.

6.33 The nature and extent of the risk assessment procedures performed may vary from entity to entity and are influenced by the following factors:

- The newness and complexity of the direct and material compliance requirements
- The auditor's knowledge of the entity's internal control over compliance with the direct and material compliance requirements obtained in previous audits or other professional engagements
- The nature of the compliance requirement
- The services provided by the entity and how they are affected by external factors
- The level of oversight by the grantor or pass-through entity
- How management addresses findings

6.34 Performing risk assessment procedures to obtain an understanding of the entity's internal control over compliance includes an evaluation of the design of controls and whether the controls have been implemented. Internal control consists of the following 5 interrelated components: control environment, the entity's risk assessment, information and communication systems, control activities, and monitoring. Circular A-133 requires the auditor to plan the testing of internal control over compliance for major programs to support a low assessed level of control risk of noncompliance for the assertions relevant to the compliance requirements for each major program. Circular A-133 does not, however, actually require the auditor to achieve a low assessed level of control risk of noncompliance. The assessment of control risk of noncompliance contributes to the auditor's evaluation of the risk that material noncompliance exists in a major program. See chapter 9, "Consideration of Internal Control Over Compliance for Major Programs," for more information.

6.35 The process of assessing inherent risk of noncompliance and control risk of noncompliance provides audit evidence about the risk that material

noncompliance may exist. The auditor uses this audit evidence as part of the basis for his or her opinion on compliance. It is important to note that paragraph 19 of SAS No. 117 states that risk assessment procedures, tests of controls, and analytical procedures alone are not sufficient to address a risk of material noncompliance. Chapter 9 of this guide discusses the auditor's consideration of internal control over compliance for major programs, including a further discussion of the assessment of control risk of noncompliance.

6.36 In determining an acceptable level of detection risk of noncompliance, the auditor considers his or her assessments of inherent risk of noncompliance and control risk of noncompliance and the extent to which he or she seeks to restrict the audit risk of noncompliance related to the major program. As assessed inherent risk of noncompliance or control risk of noncompliance decreases, the acceptable level of detection risk of noncompliance increases. Accordingly, the auditor may alter the nature, timing, and extent of the compliance tests performed based on the assessments of inherent risk of noncompliance and control risk of noncompliance. Circular A-133 requires compliance testing to include tests of transactions and such other auditing procedures necessary to provide the auditor with sufficient evidence to support an opinion on compliance. Such compliance testing serves to limit detection risk of noncompliance. Chapter 11, "Audit Sampling Considerations of Circular A-133 Compliance Audits," of this guide discusses audit sampling as it relates to a compliance audit.

6.37 In performing risk assessment procedures, the auditor should inquire of management about whether there are findings and recommendations in reports or other written communications resulting from previous audits, attestation engagements, and internal or external monitoring¹³ that directly relate to the objectives of the compliance audit. The auditor should gain an understanding of management's response to findings and recommendations that could have a material effect on the entity's compliance with direct and material compliance requirements. This information should be used to assess risk and determine the nature, timing, and extent of the audit procedures for the compliance audit, including determining the extent to which testing the implementation of any corrective actions is applicable to the audit objectives. These procedures are performed to assist the auditor in understanding whether management responded appropriately to such findings.

Assessing the Risks of Material Noncompliance

6.38 SAS No. 117 states that the auditor should assess the risks of material noncompliance whether due to fraud or error for each applicable compliance requirement¹⁴ and should consider whether any of those risks are pervasive to the entity's compliance. If the risks are pervasive, they may affect the entity's compliance with many compliance requirements. Examples of situations in which there may be a risk of material noncompliance that is pervasive to the entity's noncompliance are (a) an entity that is experiencing financial difficulty and for which there is an increased risk that grant funds will be diverted for unauthorized purposes and (b) an entity that has a history of poor recordkeeping for its federal programs.

¹³ Examples of external monitoring include regulatory reviews and program reviews by government agencies or pass-through entities. Examples of internal monitoring include reports prepared by the internal audit function and internal quality assessments.

¹⁴ See footnote 1.

6.39 As part of the audit of the financial statements, members of the audit team, including the auditor with final responsibility for the audit, should discuss the susceptibility of the entity's financial statements to material misstatement as part of the risk assessment process. Similarly, the auditor should hold a discussion of the susceptibility of the entity's major programs to material noncompliance with compliance requirements in the planning meeting of the financial statement audit. This discussion may also be held separately from the general planning meeting if the planning of the Circular A-133 compliance audit is done at a later date.

6.40 In assessing the risks of material noncompliance, the auditor may evaluate inherent risk of noncompliance and control risk of noncompliance individually or in combination. See chapter 10 for information on performing further audit procedures in response to assessed risks.

6.41 In a Circular A-133 compliance audit, the factors an auditor may consider in assessing the risks of material noncompliance are as follows:

- The complexity of the direct and material compliance requirements
- The susceptibility of the direct and material compliance requirements to noncompliance
- The length of time the entity has been subject to the direct and material compliance requirements
- The auditor's observations about how the entity has complied with the direct and material compliance requirements in prior years
- The potential effect on the entity of noncompliance with the direct and material compliance requirements
- The degree of judgment involved in adhering to the direct and material compliance requirements
- The auditor's assessment of the risks of material misstatement in the financial statement audit

6.42 In assessing the risks of material noncompliance, the auditor should

- identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks;
- relate the identified risks to what can go wrong at the relevant compliance level;
- consider whether the risks are of a magnitude that could result in noncompliance with requirements that have a direct and material effect on one or more of the entity's major programs; and
- consider the likelihood that the risks could result in noncompliance with requirements that have a direct and material effect on one or more of the entity's major programs.

Assessing the Risks of Material Noncompliance Due to Fraud

6.43 As part of the risk assessment process, the auditor should specifically assess the risks of material noncompliance with a major program's compliance requirements occurring due to fraud (fraud risk). The auditor should consider that assessment in designing the audit procedures to be performed. The assessment of fraud risk should be ongoing throughout the audit.

6.44 AU section 316, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1), provides guidance to the auditor on his or her responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement due to fraud. AU section 316 also applies to a compliance audit. Therefore, the assessment of fraud risk in a single audit relates to fraudulent acts¹⁵ that may result in material noncompliance with a major federal program's compliance requirements or the misappropriation of federal funds.

6.45 When performing the compliance audit, the auditor, using professional judgment, should adapt AU section 316 to the objectives of a compliance audit. As part of that adaptation, the auditor may consider performing the following procedures for each major program. Auditor judgment regarding specific situations found with respect to the auditee may indicate alternative procedures. The procedures listed are not intended to be an all inclusive list of procedures. These procedures include

- conducting a meeting of audit team members to discuss the risks of material noncompliance due to fraud. Depending on the number of major programs and the size of the overall audit team, it may be most effective to hold a separate meeting for each major program or groups of major programs audited by an individual segment of the overall audit team. For smaller engagements, one meeting covering all major programs may be held.
- gathering information necessary to assess fraud risk factors for major programs prior to the audit team meeting. This may include considering the results of the financial statement fraud risk assessment to determine the applicability to the compliance audit's fraud risk assessment procedures. When identifying fraud risk factors, the auditor assesses whether those risk factors, individually or in combination, present a risk of material noncompliance with compliance requirements that could have a direct and material effect on a major federal program.
- documenting entity-wide programs and controls in place to prevent, detect, and deter fraud; auditor identification and evaluation of the suitability of the design; and whether such programs and controls have been implemented. Many of these programs and controls may have been considered and documented as part of the fraud risk assessment related to the financial statement audit.
- inquiring of management (including those involved with grants management), those charged with governance, internal audit, and others about the risks of fraud related to major programs. The auditor inquires about instances of possible or actual policy violations or abuses of broad programs and controls that have come to their attention occurring during the period under audit or the period subsequent to that date. The inquiries may cover more than one major program.

6.46 Based on the information gathered, analyses, and communication among the audit team members, the auditor identifies and documents specific

¹⁵ The auditor's assessment of fraud risk focuses on fraud that originates within the entity. It does not include fraud perpetrated by persons outside the entity.

fraud risks, including the risk of management override of controls, that may result in material noncompliance with the major program's compliance requirements due to fraud. Consideration of any programs and controls in place to mitigate the risk of such fraud assists the auditor in the assessment of control risk of noncompliance of the related direct and material compliance requirement. Based on the specific fraud risks identified, and the results of tests of design and implementation of controls, the auditor determines the planned audit response (including consideration of testing major program journal entries).

6.47 Upon the completion of Circular A-133 compliance audit procedures, the auditor considers whether the results of audit procedures performed and other conditions affect the assessment of fraud risk made when planning the audit. This evaluation may provide further insight about the risks of material noncompliance due to fraud and whether there is a need to perform additional or alternative audit procedures.

6.48 Table 6-1 contains examples of fraud risk factors specific to a compliance audit. The risk factors are classified based on the 3 conditions generally present when material noncompliance due to fraud occurs:

- 1. Incentives or pressures
- 2. Opportunities
- 3. Attitudes or rationalizations

Although the risk factors cover a broad range of situations, they are examples only; accordingly, the auditor may consider additional or different risk factors. Also, the order of the examples of risk factors provided is not intended to reflect their relative importance or frequency of occurrence.

Table 6-1

Fraud Risk Factors

Incentives or Pressures

-
- Substantial political pressure on management creates an undue concern about federal award program accomplishments.
 - Imminent or anticipated adverse changes in program legislation or regulations that could impair the financial stability or profitability of the entity.
 - High degree of competition for federal awards, especially when accompanied by declining availability of federal awards nationally or regionally.
 - A stagnant tax or revenue base or declining federal funding, enrollments, or eligible participants.
 - Complex or frequently revised compliance requirements or participant requirements (such as cost sharing or matching requirements) that create incentives to shift costs or incorrectly value transactions.
 - An organizational structure that is unstable or unnecessarily complex.
 - Rapid growth due to significant increases in funds without the organizational structure to support it.

- A significant portion of program management's compensation or performance appraisal is linked to federal award budgetary or program accomplishments or other incentives, the value or results of which are contingent upon the entity achieving unduly aggressive targets for budgetary or programmatic results.
- Unrealistically aggressive budget or program goals.
- A mix of fixed price and cost reimbursable program types that create incentives to shift costs or otherwise manipulate accounting transactions.
- Financial pressure due to declining revenues or increasing expenses, creating incentive to apply nonprogram costs to federal awards.
- Significant pressure to obtain additional funding necessary to stay viable and maintain levels of service considering the financial or budgetary position of the entity or of specific federal award programs, including need for funds to finance major research and development or capital expenditures.
- Threat of imminent program termination or significant reduction in scope, the effect of which could have a material financial impact on the entity.
- Significant subrecipient or subcontract relationships for which there appears to be no clear programmatic or business justification (for example, a subrecipient providing services it does not appear qualified to provide or a vendor geographically distant from the entity when nearby vendors are available).

Opportunities

- The nature of the entity's operations provide opportunities to engage in fraud.
- Inadequate internal controls due to outdated or ineffective accounting or information systems.
- Inadequate oversight by those charged with governance over the financial reporting process and management activities.
- Inadequate monitoring by management for compliance with policies, laws, and regulations.
- Lack of appropriate segregation of duties or independent checks, especially in areas such as eligibility determination and benefit awards.
- Lack of appropriate system of authorization and approval of transactions, such as purchasing, contracting, benefit determinations, and eligibility, due to either poorly designed or outdated controls.
- Lack of timely and appropriate documentation for transactions, such as eligibility and benefit determinations.
- Lack of asset accountability or safeguarding procedures.
- Rapid changes in federal award programs, such as significant centralization or decentralization initiatives, funding shifts from federal to state or local levels, increases or decreases in participant populations, high vulnerability to significant changes in compliance requirements, or pending program elimination.
- High turnover rates or employment of accounting, internal audit, or IT staff who are not effective.

(continued)

Attitudes or Rationalizations

- An ineffective or nonexistent means of communicating and supporting the entity's values or ethics, especially regarding such matters as acceptable business practices, conflicts of interests, and codes of conduct.
- Management displaying or conveying an attitude of disinterest regarding strict adherence to federal award rules and regulations such as those related to participant eligibility, benefit determinations, or eligibility.
- An individual or individuals with no apparent executive position(s) within the entity appearing to exercise substantial influence over its affairs or over individual federal award programs (for example, a major donor, fund-raiser, or politician).
- An attitude among program personnel that given their position they, or parties related to them, are due benefits from the program, such as expenses reimbursed by the federal award or participation in the program, to which they would otherwise not be entitled, resulting in questioned costs.

Audit Materiality Considerations

6.49 Paragraph 13 of SAS No. 117 states that the auditor should establish and apply materiality levels for the compliance audit based on the governmental audit requirement. In a Circular A-133 compliance audit, there are multiple materiality considerations as discussed in the following paragraphs. As noted in paragraph A8 of SAS No. 117, in a compliance audit, the auditor's judgment about matters that are material to users of the of the auditor's report is based on consideration of the needs of users as a group, including grantors.

Materiality Differences Between the Financial Statement Audit and the Circular A-133 Compliance Audit

6.50 In auditing compliance with requirements governing major programs in a Circular A-133 compliance audit, the auditor's consideration of materiality differs from that in an audit of financial statements in accordance with GAAS and *Government Auditing Standards*. In an audit of financial statements, materiality is considered in relation to the financial statements being audited.¹⁶ In designing audit tests and developing an opinion on an auditee's compliance with requirements having a direct and material effect on each major program, however, the auditor should consider materiality in relation to each major program. Chapter 10 of this guide further discusses materiality considerations in a Circular A-133 compliance audit. Chapter 11 of this guide further discusses audit sampling in a compliance audit.

6.51 In a compliance audit, the auditor's purpose for establishing materiality levels is to

- determine the nature and extent of risk assessment procedures.
- identify and assess the risks of material noncompliance.
- determine the nature, timing, and extent of further audit procedures.

¹⁶ Because an audit of a government's financial statements under the provisions of the AICPA Audit and Accounting Guide *State and Local Governments* is based on opinion units (see footnote 5), auditors make separate materiality determinations for purposes of planning, performing, evaluating the results of, and reporting for each opinion unit.

- evaluate whether the entity complied with the direct and material compliance requirements.
- report findings of noncompliance and other matters required to be reported by the governmental audit requirement.

Paragraph A7 of SAS No. 117 notes that generally, for all of the purposes listed in this paragraph, the auditor's consideration of materiality is in relation to the government program taken as a whole. However, the governmental audit requirement may specify a different level of materiality for one or more of these purposes. For example, for purposes of reporting findings, Circular A-133 establishes a specific materiality requirement as discussed in paragraph 6.52.

Materiality for Purposes of Reporting Audit Findings

6.52 Circular A-133 requires the auditor to consider a lower level of materiality for purposes of reporting audit findings in the schedule of findings and questioned costs than for other purposes. The Circular A-133 "audit finding" materiality is different (and generally lower) than (a) the materiality used for planning and performing the single audit, (b) the materiality used for planning, performing, evaluating the results of, and reporting on the financial statement audit, or (c) expressing an opinion on the auditee's compliance with requirements having a direct and material effect on each major program.

6.53 Among other findings to be reported, Circular A-133 states that the auditor should report in the schedule of findings and questioned costs material noncompliance with the provisions of laws, regulations, contracts, or grant agreements related to a major program. (Chapter 13 of this guide describes other findings that Circular A-133 requires to be reported.) The auditor's determination of whether an instance of noncompliance with the provisions of laws, regulations, contracts, or grant agreements is material for the purpose of reporting an audit finding is in relation to 1 of the 14 types of compliance requirements (for example, activities allowed or unallowed, cash management, eligibility, or reporting) for a major program or an audit objective identified in the *Compliance Supplement*.

6.54 If, for example, when the auditor discovers one or more instances of noncompliance involving the reporting type of compliance requirement for a particular major program, certain materiality determinations should be made using professional judgment. First, the auditor should decide whether the noncompliance is material to the reporting type of compliance requirement for the particular major program. If the auditor determines the noncompliance is material to the reporting type of compliance requirement, the noncompliance would be reported as a finding in the schedule of findings and questioned costs. Second, the auditor should decide whether the discovered noncompliance is material, either individually or when aggregated with other noncompliance findings, in relation to the particular major program taken as a whole. If the auditor determines the noncompliance is material to the major program taken as a whole, the auditor would express a qualified or adverse opinion on compliance with respect to the particular major program.¹⁷

¹⁷ As discussed in chapter 4, "Auditor Reporting Requirements and Other Communication Considerations of *Government Auditing Standards*," of this guide, paragraph 5.16 of *Government Auditing Standards* states that the auditor should communicate to the auditee in writing the following
(continued)

Developing an Efficient Audit Approach

6.55 Consideration of ways to achieve maximum audit efficiency may be useful in the planning stage of the audit. Examples of ways to achieve audit efficiency follow:

- The financial statement audit and the Circular A-133 compliance audit could be planned at the same time.
- If the auditee's internal control for a compliance requirement is common to more than one major program, the transactions of those programs could be combined into one population for selecting sample sizes for internal control tests.¹⁸ (See chapter 11 of this guide for information related to audit sampling in a compliance audit.)
- Because Circular A-133 requires the planning and performance of internal control over compliance work to assess control risk of noncompliance as low (unless weaknesses are found), the auditor could take advantage of the low assessed level of control risk of noncompliance when he or she performs the substantive testing of compliance.
- Helpful quality control materials (such as planning checklists and reporting checklists) could be used.

Joint Audits and Reliance on Others

6.56 Circular A-133 encourages auditees, whenever possible, to make positive efforts to use small business, minority-owned firms, and women's business enterprises. In keeping with the spirit of that provision, certain auditees may engage such independent accounting firms on a joint-venture or subcontract basis. In these instances it may be necessary to refer to the work of other auditors. Chapter 2 of this guide discusses planning considerations for a joint audit.

(footnote continued)

matters unless they are inconsequential—immaterial violations of provisions of contracts or grant agreements, and immaterial abuse. This communication may be done in a management letter. As discussed in chapter 13, "Auditor Reporting Requirements and Other Communication Considerations in a Single Audit," of this guide, in an audit in accordance with Circular A-133 the auditor should evaluate such matters involving federal awards for the purpose of that communication based only on their consequence to the financial statements. Further, it is not necessary for the auditor to communicate such findings in the written communication required by *Government Auditing Standards* if they are otherwise reported as audit findings in accordance with Circular A-133. Assume, for example, that during the Circular A-133 compliance audit, the auditor identifies a single \$1,000 instance of non-compliance with a contractual provision for a major program. The auditor determines that the likely questioned costs are less than \$10,000 for the type of compliance requirement, the noncompliance is not material in relation to a type of compliance requirement or an audit objective identified in the *OMB Circular A-133 Compliance Supplement*, and the noncompliance is not indicative of a significant deficiency. Therefore, Circular A-133 does not require the reporting of this instance of noncompliance as a federal audit finding. However, the auditor should evaluate the noncompliance in relation to the financial statements. If it is material to the financial statements, the auditor should report it as a financial statement finding in the schedule of findings and questioned costs. If it is less than material but more than inconsequential to the financial statements, the auditor should communicate it to the auditee in writing as required by *Government Auditing Standards*.

¹⁸ Although this approach may be efficient for internal control tests, experience has shown that it is preferable to select separate samples for compliance testing from each major program because the separate samples provide clear evidence of the compliance tests performed, the results of those tests, and the conclusions reached. See chapter 11, "Audit Sampling Considerations of Circular A-133 Compliance Audits," for more information.

6.57 A common occurrence, particularly in the governmental environment, is the separation of a single audit between the principal auditor of the reporting entity and a secondary auditor of a component organization included in the financial statements of the reporting entity (see paragraph 6.17). The principal auditor's report on the financial statements of the reporting entity most often refers to the report of the secondary auditor as it relates to the financial statements of the component organization (see chapter 4 for additional reporting considerations relating to other auditors). The principal auditor also may need to refer to the programs audited by other auditors in the auditor's reports on the schedule of expenditures of federal awards and on compliance with requirements applicable to each major program and on the internal control over compliance as they relate to federal awards administered by the component organization. In such cases, AU section 543, *Part of Audit Performed by Other Independent Auditors* (AICPA, *Professional Standards*, vol. 1), contains requirements and guidance. The AICPA Audit and Accounting Guide *State and Local Governments* also illustrates an auditor's report on the financial statements that refers to the work of another auditor in the paragraph reporting on supplementary information other than required supplementary information (known as SI), such as the schedule of expenditures of federal awards.

Existence of an Internal Audit Function

6.58 Chapter 2 of this guide discusses planning considerations when the auditee has an internal audit function and the internal auditors are involved in monitoring compliance with specified requirements. Internal auditors may monitor not only compliance requirements that affect the financial statement audit, but also those that affect major programs. AU section 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements* (AICPA, *Professional Standards*, vol. 1), provides requirements and guidance related to the use of internal auditor activities in an audit including guidance when addressing the competence and objectivity of internal auditors; the nature, timing, and extent of work to be performed; and other related matters. It also provides the auditor with guidance on using internal audit to provide direct assistance in an audit.

Relevance and Effect of the Internal Audit Function in a Compliance Audit

6.59 When gaining an understanding of internal control, the auditor should obtain an understanding of the internal audit function sufficient to identify internal audit activities that are relevant to planning the audit. The work of internal auditors may affect the nature, timing, and extent of the procedures the auditor performs (a) to obtain an understanding of the entity and its environment, including its internal control over compliance, (b) to assess risk, and (c) in response to the assessed risk. In obtaining an understanding of the internal audit function as it relates to compliance requirements in a Circular A-133 compliance audit, the following procedures may be helpful in assessing the relevance of internal audit activities:

- Consideration of knowledge from prior year audits
- Reviewing how the internal auditors allocate their audit resources to compliance activities

- Reading internal audit reports to obtain detailed information about the scope of internal audit activities as it relates to compliance with direct and material compliance requirements

6.60 If, after obtaining an understanding of the internal audit function, the auditor concludes that the internal auditors' activities are not relevant to the compliance audit or it would not be efficient to consider further the work of internal auditors, no further consideration of the internal audit function is necessary. If the auditor decides that it would be efficient to consider the work of internal auditors or intends to request direct assistance from the internal auditors (see paragraph 6.64), the auditor should assess the competence and objectivity of the internal audit function as it relates to the intended effect on the Circular A-133 compliance audit, in accordance with paragraphs .09–.11 of AU section 322.

Extent of Effect of the Internal Auditors' Work

6.61 Even though the internal auditors' work may affect the auditor's procedures, the auditor should perform procedures to obtain sufficient appropriate audit evidence to support the auditor's report. The responsibility to report on the compliance audit rests solely with the auditor, and this responsibility cannot be shared with the internal auditors.

6.62 In making judgments about the extent of the effect of the internal auditors' work on the auditor's procedures over direct and material compliance requirements, the auditor considers both the risks of material noncompliance (consisting of both inherent risk of noncompliance and control risk of noncompliance) and the degree of subjectivity involved in the evaluation of the audit evidence gathered in support of compliance with direct and material compliance requirements. As either the degree of risk of material noncompliance rises or the degree of subjectivity increases, the need for the auditor to perform his or her own tests increase.

6.63 In the case in which the work of internal auditors significantly affects the nature, timing, and extent of the auditor's procedures, the auditor should perform procedures to evaluate the quality and effectiveness of the internal auditors' work. In making the evaluation, the auditor should test some of the internal auditors' work relating to each direct and material compliance requirement. These tests may be accomplished by either (a) examining some of the controls or transactions examined or compliance requirements tested by the internal auditor or (b) examining similar controls or transactions not actually examined or compliance requirements not actually tested by the internal auditor. Such testing will assist the auditor in determining the nature, timing, and extent of further audit procedures. In reaching conclusions about the internal auditors' work, the results of the auditor's tests should be compared with the results of the internal auditors' work. As noted in paragraph .26 of AU section 322, the extent of audit testing of the internal auditors' work will depend on the circumstances and should be sufficient to enable the auditor to make an evaluation of the overall quality and effectiveness of the internal audit work being considered by the auditor.

Using Internal Auditors to Provide Direct Assistance to the Auditor

6.64 In performing the single audit, the auditor may request direct assistance from the internal auditors. This direct assistance relates to work the auditor specifically requests the internal auditors to perform to complete some

aspect of the auditor's work. For example, internal auditors may assist the auditor in obtaining an understanding of internal control over compliance or in performing tests of controls or tests of compliance. Paragraphs .18–.22 of AU section 322 provide guidance regarding the extent of the effect of the internal auditor's work on audit procedures. When direct assistance is provided, the auditor should assess the internal auditors' competence and objectivity and supervise, review, evaluate, and test the work performed by internal auditors to the extent appropriate in the circumstances. The auditor should inform the internal auditors of their responsibilities, the objectives of the procedures they are to perform, and matters that may affect the nature, timing, and extent of audit procedures, such as possible compliance and auditing issues. The auditor should also inform the internal auditors that all significant compliance and auditing issues identified during the audit should be brought to the auditor's attention.

Communications With the Cognizant or Oversight Agency for Audit and Others

6.65 Chapter 2 of this guide discusses how the auditor may communicate with grantor agencies and other entities in planning the financial statement audit, the need to document that communication, and the types of topics that might be discussed. In a single audit, the auditor also may communicate with the cognizant agency for audit or the oversight agency for audit. If a planning meeting is held with that agency, the following matters also may be discussed:

- The scope of the compliance testing of federal programs
- The intended use of the *Compliance Supplement*
- The identification of federal awards, including those that are considered to be major programs
- The form and content of the supplemental schedule of expenditures of federal awards
- The testing of the monitoring of subrecipients
- The scope of the review and testing of internal control over compliance
- The testing of compliance requirements
- The status of prior-year findings and questioned costs
- Federal agency or pass-through entity management decisions on prior-year findings
- Compliance requirements and any changes to those requirements

State and Local Compliance Requirements

6.66 In addition to testing and reporting on the compliance requirements as provided by *Government Auditing Standards* and Circular A-133, there may be state-imposed requirements on state funds provided to political subdivisions or not-for-profit entities (in this example, the state is not a pass-through entity). Even though such nonfederal awards are not considered part of the total federal awards expended by the auditee and are not subject to audit in accordance with Circular A-133, auditors would still need to consider such laws and regulations under GAAS and *Government Auditing Standards*. Therefore, in connection with the financial statement audit, auditors should obtain an understanding of

applicable state and local compliance and reporting requirements that have a direct and material effect on the financial statements being audited. Chapter 3 of this guide discusses possible audit procedures to assess the completeness of management's identification of compliance requirements in connection with the financial statement audit. Chapter 7 of this guide discusses auditee reporting considerations.

Desk Reviews and On-Site Reviews

6.67 In addition to the quality control requirements set forth in *Government Auditing Standards* as discussed in chapter 2 of this guide, cognizant agencies for audit have implemented procedures for evaluating the quality of audits. These procedures include both desk reviews and on-site reviews (note that the oversight agencies for audit also may perform these reviews).¹⁹ As a part of the cognizant agencies' evaluation of the completed reports of such engagements, and, as required by Circular A-133, the supporting audit documentation should be made available upon request by the representative of the federal agency. Audit documentation typically is reviewed at a location agreed upon by the cognizant agency for audit and the independent auditor. (Paragraph 6.11 and chapter 2 of this guide further discuss access to audit documentation.)

6.68 Whenever a review of the audit report or audit documentation discloses an inadequacy, the audit firm is contacted for corrective action. Where major inadequacies are identified and the representative of the cognizant agency for audit determines that the audit report and the audit documentation are substandard, cognizant agencies may take further steps. In those instances in which the audit is determined to be substandard by the federal agency, the matter may be submitted to state boards of public accountancy.

Restriction on the Auditor's Preparation of Indirect Cost Proposals

6.69 Circular A-133 precludes the auditor who prepares the indirect cost proposal or cost allocation plan from performing the single audit when indirect costs recovered by the auditee during the prior year exceeded \$1 million.²⁰ This restriction applies to the base year used in the preparation of the indirect proposal or cost allocation plan and to any subsequent years in which the resulting indirect cost agreement or cost allocation plan is used to recover costs. For example, an auditor who prepares an indirect cost proposal or cost allocation plan that is used as the basis for charging indirect costs in the fiscal year ending June

¹⁹ Among the tools that the cognizant and oversight agencies for audit use to perform desk reviews are two checklists from the President's Council on Integrity and Efficiency: the *Guide for Initial Review of A-133 Audit Reports* and the *Guide for Quality Control Review for A-133 Audits*. Copies of these guides are on the Internet at www.ignet.gov/pande/audit/psingle.html.

²⁰ Paragraph 3.28d of *Government Auditing Standards* addresses the effect that the preparation of an entity's indirect cost proposal or cost allocation plan has on an auditor's independence. *Government Auditing Standards* allows the auditor to prepare the indirect cost proposal or cost allocation plan provided the amounts are not material to the financial statements, management assumes responsibility for all significant assumptions and data, and supplemental safeguards are implemented. (Chapter 2 of this guide discusses the independence requirements of *Government Auditing Standards*.) However, even if the auditor's preparation of an indirect cost proposal or cost allocation plan does not impair the auditor's independence, Circular A-133 continues to prohibit an auditor who prepared that proposal or plan from performing the Circular A-133 compliance audit when indirect costs recovered by the entity during the prior year exceeded \$1 million.

30, 20X1, is not permitted to perform the 20X1 single audit (assuming that the indirect costs recovered during the prior year exceeded \$1 million).

American Recovery and Reinvestment Act Considerations *

6.70 When planning an audit in accordance with Circular A-133, the receipt or expenditure of Recovery Act funds is an important factor to consider early in the planning process. This is largely due to the imposition by the Recovery Act of additional compliance requirements on recipients that are specific to Recovery Act funds.

6.71 One important requirement for recipients is that Recovery Act funds cannot be comingled with other funds. Recipients must maintain records that identify the source and application of Recovery Act funds, and the funds are required to be identified separately in any reporting. This separate identification is also applicable when receiving Recovery Act funds for existing programs and grants, or when Recovery Act funds are used in conjunction with other funds to complete projects. Federal agencies are required to specifically identify Recovery Act awards, regardless of whether the funding is provided under a new or existing Catalog of Federal Domestic Assistance (CFDA) number. The funding award document should contain the information federal agencies are required to provide to recipients regarding Recovery Act funds.

6.72 Although federal agencies are required to separately identify Recovery Act awards, the award may not have a new CFDA number. New program awards of Recovery Act funding will be assigned a new CFDA number. For existing programs utilizing Recovery Act funding, a new CFDA number is optional. Therefore, an existing program award of Recovery Act funding may or may not have a new CFDA number. As mentioned in the preceding paragraph, Recovery Act funds must be accounted for separately regardless of whether the funds are granted under a new or existing CFDA number.

6.73 In planning an audit that includes Recovery Act funding, it is important that the compliance requirements are identified early in the planning process. In addition to the government-wide compliance requirements applicable to Recovery Act funds, individual agency or program awards may contain additional compliance and reporting requirements. Another related factor is that the auditor may have to use multiple sources to determine the compliance requirements for such funds. Compliance requirements for a specific Recovery Act award may be found in one or several of the following locations:

- *Compliance Supplement*
- *Compliance Supplement* addendums
- Grant award documents (including terms and conditions section)
- OMB guidance memorandums

* Information in this guide related to the American Recovery and Reinvestment Act of 2009 (Recovery Act) is based upon the latest information available at the time of this writing. However, this information is subject to change because guidance from the OMB is being issued and updated on an ongoing basis. It is important for recipients of Recovery Act funding, and their auditors, to monitor the guidance issued. For the latest OMB guidance, go to the OMB website at www.whitehouse.gov/omb/recovery_default. Information can also be found at the Recovery Act Resource Center on the Governmental Audit Quality Center website, which is open to the public at www.aicpa.org/INTERESTAREAS/GOVERNMENTALAUDITQUALITY/RESOURCES/RECOVERYACTRESOURCECENTER/Pages/default.aspx and at the U.S. Government's official Recovery Act website at www.recovery.gov.

- Agency Recovery Act websites
- Text of the Recovery Act
- Code of Federal Regulations

See chapter 5 of this guide for links to websites that contain OMB issued guidance related to Recovery Acts funds. Funding agency websites may also be an important source of information. The text of the Recovery Act can be accessed at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h1enr.pdf.

6.74 Accountability is an important provision of the Recovery Act. OMB issued Recovery Act implementing guidance stating that quality control reviews (QCR) with an emphasis on the Recovery Act funds are to be performed by the federal offices of inspectors general, with the QCR results being posted to www.recovery.gov. These reviews will likely occur for years ending between June 30, 2010, and June 30, 2011.

Chapter 7

Schedule of Expenditures of Federal Awards

Note: The audit required by the Single Audit Act Amendments of 1996 and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133), should be performed in accordance with *Government Auditing Standards*. Part I, "Government Auditing Standards Audits," (chapters 2–4 of this guide) discusses financial statement audits under generally accepted auditing standards and *Government Auditing Standards*. The guidance in parts I and II, "Circular A-133 Audits," (chapters 5–14 of this guide) is applicable for those auditors performing an audit under the Single Audit Act Amendments of 1996 and Circular A-133.

Information related to the American Recovery and Reinvestment Act of 2009 (Recovery Act) can be found in a section located at the end of each chapter in part II of this guide. See the section titled "American Recovery and Reinvestment Act Considerations" beginning at paragraph 7.22 in this chapter. See also the preface section titled "Impact of the American Recovery and Reinvestment Act of 2009 on Single Audits."

Overview of Schedule Requirements

7.01 Circular A-133 states that the auditor should determine whether the Schedule of Expenditures of Federal Awards (SEFA) is presented fairly in all material respects in relation to the auditee's financial statements taken as a whole. AU section 551A, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents* (AICPA, *Professional Standards*, vol. 1) and paragraph .07 of AU section 550A, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1), provide guidance on such reporting.* The SEFA, prepared by the auditee, reports the total expenditures for each federal program and serves as the primary basis for the auditor's major program determination. (See chapter 5, "Overview of the Single Audit Act, Circular A-133, and the *Compliance Supplement*," of this guide for the Circular A-133 definition of federal programs). This chapter describes the federal agency, pass-through entity, and auditee requirements relating to the identification of federal awards, the auditor's requirements related to the schedule, and the general presentation requirements governing the schedule, pass-through awards, noncash awards, and endowment funds. Chapter 13, "Auditor Reporting Requirements and Other

* See footnotes * and † in paragraph 5.05 of this guide for information on recently issued Statements on Auditing Standards related to AU section 551A, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents*, and AU section 550A, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1).

Communication Considerations in a Single Audit," of this guide discusses the auditor's reporting on the schedule. Appendix A (paragraph 7.25) presents illustrative schedules of expenditures of federal awards. Appendix B (paragraph 7.26) presents an illustrative audit plan and a disclosure checklist for the SEFA.

Identification of Federal Awards

Federal Agency and Pass-Through Entity Requirements

7.02 According to Circular A-133, federal awarding agencies and pass-through entities have certain responsibilities related to the federal awards they make. Each recipient or subrecipient should be informed of the *Catalog of Federal Domestic Assistance* (CFDA) title and number, the award's name and number, the award year, and whether the award is for research and development (R&D). When some of this information is not available, the federal agency or pass-through entity should provide the information necessary to describe the federal award clearly.

Auditee Requirements

7.03 Circular A-133 states that the auditee should identify in its accounts all federal awards received and expended, as well as the federal programs under which they were received. Federal program and award identification includes, as applicable, the CFDA title and number, the award number and year, the name of the federal granting agency, and the name of the pass-through entity. Using this information, the auditee should be able to reconcile amounts presented in the financial statements to related amounts in the SEFA.

Auditor Requirements Related to the SEFA

Issuing an "In Relation To" Opinion

7.04 Circular A-133 states that the auditor should determine and provide an opinion on whether the SEFA is presented fairly in all material respects in relation to the auditee's financial statements taken as a whole. Accordingly, the auditor need not apply procedures as extensive as would be necessary to express an opinion on the SEFA itself. Paragraphs .04–.07 of AU section 550A provide guidance on the auditor's consideration of supplementary information, including auditor responsibilities and related procedures. It states that the auditor should read the supplementary information and consider whether such information, or the manner of its presentation, is materially inconsistent with information, or the manner of its presentation, appearing in the financial statements. AU section 551A provides guidance on the form and content of the reporting when the auditor expresses an "in relation to" opinion. If the audit of the basic financial statements does not encompass the financial information in the schedule, the auditor should modify or redirect procedures to support the "in relation to" opinion required by Circular A-133.

Additional Auditor Requirements Relating to Compliance Audit Objectives

7.05 The SEFA is unlike certain other supplementary information included in documents containing audited financial statements in that it serves as the primary basis for the auditor's major program determination, which is

an important aspect of performing a Circular A-133 compliance audit. Circular A-133 places the responsibility of preparing the schedule and including certain elements (as described in paragraph 7.10) on the auditee. However, Circular A-133 places the responsibility for determination of major programs on the auditor and the SEFA provides the basis for making that determination. (See chapter 8, "Determination of Major Programs," of this guide.) Therefore, appropriate major program determination by the auditor is dependent on the accuracy and completeness of the information that makes up the SEFA.

7.06 Chapter 9, "Consideration of Internal Control Over Compliance for Major Programs," of this guide further discusses the auditor's responsibility for considering internal control over compliance, including obtaining an understanding of the five components of internal control over compliance sufficient to assess the risks of material noncompliance. This understanding, coupled with the auditor's understanding of internal control over financial reporting required for the financial statement audit, should include the auditee's controls over the accuracy and completeness of the expenditure amounts reported on the schedule, as well as controls over the accuracy of the CFDA numbers. Procedures may include inquiring of entity personnel, observing the application of specific controls, and inspecting documents and reports used in the preparation of the schedule. The understanding obtained should be sufficient for the auditor to assess the risks of material misstatement of the SEFA and to design the nature, timing, and extent of further compliance audit procedures to test the accuracy and completeness of the schedule.¹

7.07 Further compliance audit procedures should be performed to obtain sufficient appropriate audit evidence supporting the accuracy and completeness of the SEFA, including the identification of federal programs in the schedule. In testing accuracy and completeness of the SEFA, the auditor may use evidence obtained from audit procedures performed during the audit of the financial statements regarding the accuracy, completeness, and classification of recorded revenues and expenditures. Additionally, the auditor may consider reviewing an auditee prepared reconciliation of amounts reported in the schedule and the notes to the schedule to corresponding amounts reported in the financial statements or other underlying records used to prepare the schedule (for example, the general ledger, reimbursement requests, loan agreements, or other supporting documentation). The auditor may also consider sending confirmations to granting federal agencies or pass-through entities in an audit of a subrecipient. Finally, because Circular A-133 requires the auditee to include certain elements in the schedule, the procedures should also include a review of the auditee's schedule for the required elements set forth in Circular A-133 and described in paragraph 7.10.

7.08 When the auditor identifies deficiencies in internal control that relate to the auditee's preparation of a complete and accurate schedule, the auditor should evaluate the severity of each deficiency in internal control identified to determine whether the deficiency, individually or in combination, is a significant deficiency or material weakness relating to internal control over financial reporting, internal control over compliance, or both. Chapter 3, "Financial Statement Audit Considerations of *Government Auditing Standards*" and

¹ The auditor's risk assessment may also be used in deciding what additional procedures, if any, should be performed in order to render an "in relation to" opinion (see paragraph 7.04).

chapter 9 of this guide include a discussion of internal control and provide guidance to assist auditors in making an assessment of deficiencies in internal control. If a deficiency in internal control is determined to be a significant deficiency or material weakness, the auditor should report a finding in the schedule of findings and questioned costs. Chapter 13 of this guide further discusses the reporting of findings and the schedule of findings and questioned costs.

General Presentation Requirements

Basis of Accounting

7.09 Circular A-133 does not specifically prescribe the basis of accounting to be used by the auditee to prepare the SEFA, although it does state that the determination of when an award is expended should be based on when the activity related to the award occurs and provides the guidance shown in table 7-1. (Circular A-133 also specifies the values that should be presented for certain types of awards; see table 7-2 in paragraph 7.19). Some schedules or some awards in schedules may be presented on a basis of accounting that differs from that used in the financial statements. In any case, the auditee should disclose the basis of accounting and the significant accounting policies used in preparing the schedule. As noted in paragraph 7.03, the auditee should also be able to reconcile amounts presented in the financial statements to related amounts in the SEFA.

Table 7-1

Basis for Determining When Federal Awards Are Expended

| <i>Federal Awards</i> | <i>Basis for Determining When Expended</i> |
|-----------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------|
| Grants, cost reimbursement contracts, cooperative agreements, and direct appropriations | When the expenditure or expense transactions occur |
| Amounts passed through to subrecipients | When the disbursement is made to the subrecipient |
| Loan and loan guarantees | When the loan proceeds are used (See the further discussion on loans and loan guarantees in table 7-2 and paragraph 7.20.) |
| Donated property, including donated surplus property | When the property is received |
| Food commodities | When the food commodities are distributed or consumed |
| Interest subsidies | When amounts are disbursed entitling the entity to the subsidy |
| Insurance | When the insurance is in force |
| Endowments | When federally restricted amounts are held |
| Program income | When received or used |

Required Schedule Contents

7.10 Circular A-133 states that the auditee should prepare an SEFA for the period covered by the auditee's financial statements. At a minimum, the schedule should:

- List individual federal programs by federal agency. For federal programs included in a cluster of programs, list individual federal programs within a cluster of programs. (Chapter 5 of this guide discusses clusters of programs.) For R&D, the total federal awards expended should be shown either by individual award or by federal agency and major subdivision within the federal agency. For example, the National Institutes of Health is a major subdivision in the Department of Health and Human Services (the federal agency).
- For federal awards received as a subrecipient, include the name of the pass-through entity and the identifying number assigned by the pass-through entity.
- Provide the total federal awards expended for each individual federal program and the CFDA number or other identifying number when the CFDA information is not available.
- Include notes that describe the significant accounting policies used in preparing the schedule.
- For federal awards received as a pass-through entity, identify, to the extent practical, the total amount provided to subrecipients from each federal program. (Chapter 12, "Audit Considerations of Federal Pass-Through Awards," of this guide further discusses the audit considerations of federal pass-through awards.)
- Include, in either the schedule or a note to the schedule, the value of federal awards expended in the form of noncash assistance, the amount of insurance in effect during the year, and loans or loan guarantees outstanding at year end (see paragraph 7.20 and table 7-2).

Appendix A (paragraph 7.25) presents example SEFAs. For assistance in determining whether all required elements are included, see the illustrative disclosure checklist for the SEFA in appendix B (paragraph 7.26).

Providing Additional Information

7.11 Although not required, the auditee may choose to provide other information (in addition to the foregoing requirements) that is requested by federal awarding agencies and pass-through entities to make the schedule easier to use. For example, when a federal program has multiple award years, the auditee may choose to list the amount of federal awards expended for each award year separately, if so requested by a federal agency.

Schedule May Not Agree With Other Federal Award Reporting

7.12 The information included in the SEFA may not fully agree with other federal award reports that the auditee submits directly to federal granting agencies because, among other reasons, the award reports (a) may be prepared for a different fiscal period and (b) may include cumulative (from prior years) data rather than data for the current year only.

Inclusion of Nonfederal Awards

7.13 Circular A-133 does not require nonfederal awards (for example, state awards) to be presented in the schedule. However, to meet state or other requirements, auditees may decide to include such awards in the schedule. See paragraph 7.14 for information on modifications to the SEFA when including nonfederal awards in that schedule.

Considerations Relating to State Awards

7.14 Several state governments have auditing and reporting requirements for state awards that are similar to those for federal awards under Circular A-133. In these states, auditors may be engaged to test and report on compliance with the state compliance requirements as provided in the state award(s) and under applicable state laws or regulation. Some states require a separate compliance audit with a separate schedule of expenditures of state awards. However, others accept a combined schedule of federal and state awards along with additional testing of the state expenditures. If state (or other nonfederal) awards are included in the SEFA they should be segregated and clearly designated as nonfederal. The title of the schedule should also be modified to indicate that nonfederal awards are included.

CFDA Number Not Available

7.15 The auditee may be unable to obtain the CFDA number, which is sometimes the case for new federal programs and R&D programs. In addition, cost-type contracts normally will not have a CFDA number. When the CFDA number is not available, the auditee has alternatives for presenting that information. The auditee could indicate that the CFDA number is not available and include, if available, another identifying number, such as a contract or grant number. The auditee also could apply the guidance presented in the Federal Audit Clearinghouse's data collection form instructions for when a federal program does not have a CFDA number. Specifically, if the program has a contract or grant number, the number shown as the CFDA number could be the awarding agency's 2-digit prefix listed for the agency in an appendix to the form's instructions (or 99 if the agency is not listed) followed by the contract or grant number. If the program does not have a contract or grant number, the number shown as the CFDA number could be the awarding agency's 2-digit prefix (or 99) followed by "UNKNOWN."

Pass-Through Awards

Treatment of Pass-Through Awards

7.16 Circular A-133 defines a *subrecipient* as an entity that expends federal awards that are received from a pass-through entity to carry out a federal program. State or local government redistributions of federal awards to subrecipients, known as "pass-through awards," should be treated by the subrecipient as though they were received directly from the federal government. That is, pass-through awards should be included in the scope of the single audit on the same basis as that of federal awards that are received directly. Chapter 12 of this guide further discusses the audit considerations of federal pass-through awards. As noted in paragraph 7.10, in addition to the other general presentation requirements, Circular A-133 states that the schedule should include the name of the pass-through entity and the identifying number assigned by the pass-through entity for federal awards received as a subrecipient.

Commingled Assistance

7.17 The individual sources (that is, federal, state, and local) of federal awards may not be separately identifiable because of commingled assistance from different levels of government. If the commingled portion cannot be separated to specifically identify the individual funding sources, the total amount should be included in the schedule, with a note to the schedule describing the commingled nature of the funds.

Noncash Awards

Treatment of Noncash Awards

7.18 Most federal awards are in the form of cash awards. However, a number of federal programs do not involve cash transactions. These programs may include loans and loan guarantees (including interest subsidies), insurance, endowments, free rent, food stamps, food commodities, and donated property (including donated surplus property). Circular A-133 states that the value of federal awards expended in the form of noncash assistance should be reported either on the face of the schedule or disclosed in the notes to the schedule. However, Circular A-133 also states that although it is not required, it is preferable to present this information in the schedule rather than in the notes to the schedule. Paragraph 7.09 and chapter 5 of this guide discuss the determination of when awards, including noncash awards, are considered to be expended.

Determining the Value of the Noncash Awards Expended

7.19 Table 7-2 shows the bases generally used to determine the value of noncash awards expended. (See Section 205 of Circular A-133 for additional details.)

Table 7-2

Determining the Value of Noncash Awards Expended

| <i>Types of Noncash Awards</i> | <i>Basis Used to Determine the Value of Noncash Awards Expended</i> |
|-----------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Loans and loan guarantees (loans), including interest subsidies | Value equals amount of new loans made or received during the fiscal year plus the balance of loans from previous years for which the federal government imposes continuing compliance requirements (see paragraph 7.20), plus any interest subsidy, cash, or administrative cost allowance received. The proceeds of loans that were received and expended in prior years are not considered federal awards expended when the laws, regulations, and the provisions of contracts or grant agreements pertaining to such loans impose no continuing compliance requirements other than to repay the loans. |

(continued)

| <i>Types of Noncash Awards</i> | <i>Basis Used to Determine the Value of Noncash Awards Expended</i> |
|------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Loans at institutions of higher education | Value the same as for loans and loan guarantees (loans), including interest subsidies, mentioned previously, except that when loans are made to students but the institution of higher education does not make the loans, the value equals only the amount of new loans made during the year. The balance of loans for previous years is not considered federal awards expended because the lender accounts for the prior balances. |
| Insurance | Value equals the fair value of the insurance contract at the time of receipt, or the assessed value provided by the federal agency. |
| Endowments | Value equals the cumulative balances of federally restricted amounts. |
| Free rent | Value equals the fair value at the time of receipt, or the assessed value provided by the federal agency. Free rent is not considered an award expended unless it is received as part of an award to carry out a federal program. |
| Food stamps, food commodities, and donated property (including donated surplus property) | Value equals the fair value at the time of receipt, or the assessed value provided by the federal agency. |

Loan and Loan Guarantee Continuing Compliance Requirements

7.20 As noted previously, in determining the value of total noncash awards expended for loans and loan guarantees, auditees should include the balances of loans from previous years in the schedule if the federal government imposes continuing compliance requirements.² Circular A-133 does not specifically define the term *continuing compliance requirements*, although some federal agencies indicate that their loans have continuing compliance requirements, such as the U.S. Department of Housing and Urban Development (HUD) with regard to their insured, direct, and HUD-held loans. Auditors may use professional judgment in evaluating the auditee's determination of whether continuing compliance requirements are significant enough to require inclusion of prior-year loan or loan guarantee balances. For example, if in a prior year an auditee expended the proceeds of a federal loan to construct a building, and the current-year activity consists only of loan repayments and a requirement by the federal lender for the auditee to submit a report that details only loan payment information, it may not be necessary to include the prior year's loan balance in determining

² See paragraph 7.18 for a discussion of the presentation options for noncash assistance.

the total amount of loans expended. However, if the federal lender requires the auditee to ensure on an ongoing basis that a certain percentage of the building is rented to low-income residents, it would likely be necessary to include the prior year's loan balance in determining the total amount of loans expended. If there is any question about an auditee's determination of whether continuing compliance requirements are significant enough to require inclusion of the balances of prior loans or loan guarantees, the auditor might consider contacting the federal agency's Office of Inspector General for assistance.

Documentation Requirements

7.21 The audit procedures performed on the SEFA supports the basis for the auditor's major program determination, as well as the auditor's "in relation to" opinion on the schedule. The audit work performed on the schedule to support these engagement objectives should be documented in accordance with AU section 339, *Audit Documentation* (AICPA, *Professional Standards*, vol. 1). Documenting the audit work performed on the schedule in an audit plan is an effective way to record the audit procedures performed, relevant audit evidence obtained, conclusions reached and significant findings relating to the schedule, if any. See appendix B at paragraph 7.26 for an illustrative audit plan related to the SEFA.

American Recovery and Reinvestment Act Considerations[†]

7.22 The Special Tests and Provisions section of the 2010 *OMB Circular A-133 Compliance Supplement (Compliance Supplement)*[‡] (Part 3, Section N) and appendix 7, "Other Circular A-133 Advisories," describe the compliance requirements for separate accountability of Recovery Act funding and other related requirements. Recipients of Recovery Act awards agree (as a condition of accepting the award) to maintain records that identify adequately the source and application of Recovery Act awards. In addition, recipients agree to identify the expenditure of Recovery Act awards separately on the SEFA and the data collection form. Recipients also agree to separately identify to each subrecipient, through documentation at the time of subaward and at the time of disbursement of funds, the federal award number, CFDA number, and amount of Recovery Act funds. This separate identification should also be made for Recovery Act funds subawarded for an existing program. Also, recipients should require subrecipients to include information on their SEFA that specifically identifies Recovery Act funds similar to the requirements for recipients. These recipient responsibilities apply to informing "first-tier" subrecipients (those who receive an award

[†] Information in this guide related to the American Recovery and Reinvestment Act of 2009 (Recovery Act) is based upon the latest information available at the time of this writing. However, this information is subject to change because guidance from the Office of Management and Budget (OMB) is being issued and updated on an ongoing basis. It is important for recipients of Recovery Act funding, and their auditors, to monitor the guidance issued. For the latest OMB guidance, go to the OMB website at www.whitehouse.gov/omb/recovery.default. Information can also be found at the Recovery Act Resource Center on the Governmental Audit Quality Center website, which is open to the public at www.aicpa.org/INTERESTAREAS/GOVERNMENTALAUDITQUALITY/RESOURCES/RECOVERYACTRESOURCECENTER/Pages/default.aspx and at the U.S. Government's official Recovery Act website at www.recovery.gov.

[‡] At the time of this writing, the 2010 *OMB Circular A-133 Compliance Supplement (Compliance Supplement)* is expected to include the information contained in this section. It is important that readers be alert to final issuance of the 2010 *Compliance Supplement*, which will be available on the OMB website at www.whitehouse.gov/omb/grants/circulars/.

directly from the recipient). Therefore, awards made by first-tier subrecipients and below may not have included requirements in the grant agreement for separate identification and presentation of Recovery Act awards on the SEFA. However, where possible (for example, programs with a Recovery Act CFDA number or where the information was included in the grant agreement), separate identification of Recovery Act awards should be made on the SEFA. This separate identification of Recovery Act awards on the SEFA by subrecipients allows the recipient to properly monitor subawards of Recovery Act funds.

7.23 Because the SEFA serves as the primary basis for the auditor's major program determination, the identification of expenditures of Recovery Act awards in the SEFA is an important consideration. Appendix 7 of the 2010 *Compliance Supplement* includes requirements and guidance relating to the effect of the Recovery Act on major program determination. See the discussion in chapter 8 of this guide for more information on the effect of expenditures of Recovery Act awards on major program determination.

7.24 Auditors should consider the requirements discussed in the preceding paragraphs when performing procedures for the purpose of providing the in relation to reporting on the SEFA and when performing other procedures on the SEFA in conjunction with compliance testing.

7.25

Appendix A—Illustrative Schedules of Expenditures of Federal Awards *

Example Entity Schedule of Expenditures of Federal Awards¹ For the Year Ended June 30, 20X1

| <i>Federal Grantor / Pass-Through Grantor / Program or Cluster Title</i> | <i>Federal CFDA Number²</i> | <i>Pass-Through Entity Identifying Number³</i> | <i>Federal Expenditures⁴</i> |
|----------------------------------------------------------------------------|----------------------------------------|-----------------------------------------------------------|-----------------------------------------|
| Department of Agriculture Direct Programs | | | |
| Summer Food Service Program for Children—Commodities | 10.559 | | \$ 46,000 |
| <i>Total Department of Agriculture Direct Programs</i> | | | \$ 46,000 |
| Department of Housing and Urban Development Direct Programs | | | |
| Community Development Block Grant—Entitlement Grants (note 3) | 14.218 | | \$1,235,632 |
| Section 8 Housing Choice Vouchers | 14.871 | | 800,534 |
| <i>Total Department of Housing and Urban Development Direct Programs</i> | | | \$2,036,166 |
| Department of Education Direct Programs | | | |
| Impact Aid | 84.041 | | \$ 372,555 |
| Literacy Through School Libraries | 84.364 | | 28,655 |
| Subtotal Department of Education Direct Programs | | | \$ 401,210 |
| Department of Education Pass-Through Programs From: | | | |
| State Department of Education—Title I Grants to Local Educational Agencies | 84.010 | 23-8345-7612 | \$1,239,398 |
| <i>Total Department of Education Pass-Through Programs</i> | | | \$1,640,608 |
| <i>Total Expenditures of Federal Awards</i> | | | <i>\$3,722,774</i> |

The accompanying notes are an integral part of this schedule.

* Appendix A, "Illustrative Schedules of Expenditures of Federal Awards," does not reflect the additional requirements of the Recovery Act.

¹ To meet state or other requirements, auditees may decide to include certain nonfederal awards (for example, state awards) in this schedule. If such nonfederal data are presented, they should be segregated and clearly designated as nonfederal. The title of the schedule also should be modified to indicate that nonfederal awards are included. See paragraphs 7.13–14.

² When the Catalog of Federal Domestic Assistance number is not available, the auditee has alternatives for presenting that information. See paragraph 7.15.

³ When awards are received as a subrecipient, the schedule should include the identifying number assigned by the pass-through entity.

⁴ Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133), states that the value of federal awards expended in the form of noncash assistance, the amount of insurance in effect during the year, and loans or loan guarantees outstanding at year end should be included in either the schedule or a note to the schedule. Although it is not required, Circular A-133 states that it is preferable to present this information in the schedule (versus the notes to the schedule). If the auditee presents noncash assistance in the notes to the schedule, such amounts are still required to be included in Part III of the data collection form (DCF).

Example Entity

Notes to the Schedule of Expenditures of Federal Awards

For the Year Ended June 30, 20X1

Note 1. Basis of Presentation⁵

The accompanying schedule of expenditures of federal awards (the "Schedule") includes the federal grant activity of Example Entity under programs of the federal government for the year ended June 30, 20X1. The information in this schedule is presented in accordance with the requirements of the Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Because the schedule presents only a selected portion of the operations of Example Entity, it is not intended to and does not present the financial position, changes in net assets or cash flows of Example Entity.

Note 2. Summary of Significant Accounting Policies⁶

Expenditures reported on the Schedule are reported on the (identify basis of accounting) basis of accounting. Such expenditures are recognized following the cost principles contained in OMB Circular A-122, *Cost Principles for Non-profit Organizations*, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Negative amounts shown on the Schedule represent adjustments or credits made in the normal course of business to amounts reported as expenditures in prior years. Pass-through entity identifying numbers are presented where available.

Note 3. Subrecipients⁷

Of the federal expenditures presented in the schedule, Example Entity provided federal awards to subrecipients as follows:

| <i>CFDA Number</i> | <i>Program Name</i> | <i>Amount Provided to Subrecipients</i> |
|--------------------|------------------------------------------------------|-----------------------------------------|
| 14.218 | Community Development Block Grant—Entitlement Grants | \$423,965 |

⁵ This note is included to meet the Circular A-133 requirement that the schedule include notes that describe the significant accounting policies used in preparing the schedule.

⁶ See footnote 5.

⁷ Circular A-133 states that the schedule of expenditures of federal awards should include, to the extent practical, an identification of the total amount provided to subrecipients from each federal program. Although this example includes the required subrecipient information in the notes to the schedule, the information may be included on the face of the schedule as a separate column or section, if the auditee prefers.

Example Entity University
Schedule of Expenditures of Federal Awards⁸
For the Year Ended June 30, 20X1

| <i>Federal Grantor/Pass-Through Grantor/Program or Cluster Title</i> | <i>Federal CFDA Number⁹</i> | <i>Pass-Through Entity Identifying Number¹⁰</i> | <i>Federal Expenditures^{11,12}</i> |
|-------------------------------------------------------------------------------------|--------------------------------------------|------------------------------------------------------------------------|-------------------------------------------------|
| <i>Student Financial Aid—Cluster</i> | | | |
| Department of Education Direct Programs ¹³ | | | |
| Federal Pell Grant Program | 84.063 | | \$ 4,757,853 |
| Federal Family Education Loans | 84.032 | | 2,143,587 |
| Federal Supplemental Educational Opportunity Grants | 84.007 | | 974,873 |
| Federal Work-Study Program | 84.033 | | 575,417 |
| Academic Competitiveness Grants | 84.375 | | 230,584 |
| National Science and Mathematics Access to Retain Talent (SMART) Grants | 84.376 | | 239,438 |
| Federal Perkins Loan Program (note 3) | 84.038 | | <u>1,548,343</u> |
| <i>Total Department of Education Direct Programs</i> | | | \$10,470,095 |
| Department of Health and Human Services Direct Programs | | | |
| Nursing Student Loans (note 3) | 93.364 | | \$ 823,582 |
| Health Professions Student Loans (note 3) | 93.342 | | <u>689,021</u> |
| <i>Total Department of Health and Human Services Direct Programs</i> | | | <u>\$ 1,512,603</u> |
| <i>Total Student Financial Aid Cluster</i> | | | \$11,982,698 |
| | | | <i>(continued)</i> |

⁸ See footnote 1.⁹ See footnote 2.¹⁰ See footnote 3.¹¹ See footnote 4.¹² It is acceptable to present large, material construction contracts in the footnotes to the schedule, rather than on the face of the schedule. If the auditee presents these amounts in the footnotes, such amounts are still required to be included in part III of the DCF.¹³ Institutions of higher education often participate in certain loan and loan guarantee programs (for example, the Federal Family Education Loan Program and the Federal Direct Loan Program), as shown here. Circular A-133 requires that when loans are made to students but the institution of higher education does not make the loans, the value of the loans made during the year is considered federal awards expended. Those loans and loan guarantees should be reported either on the face of the schedule or disclosed in the notes to the schedule, as discussed in paragraph 7.20. Accordingly, these amounts should be reported in part III of the DCF.

| <i>Federal Grantor /Pass-Through Grantor/Program or Cluster Title</i> | <i>Federal CFDA Number</i> | <i>Pass-Through Entity Identifying Number</i> | <i>Federal Expenditures</i> |
|--------------------------------------------------------------------------------------------------------------------------|--------------------------------|-----------------------------------------------------------|---------------------------------|
| Research and Development— Cluster (note 4)¹⁴ | | | |
| Department of Defense Direct Programs | | | |
| Department of Army Collaborative Research and Development | 12.114 | | \$ 87,403 |
| Military Medical Research and Development | 12.420 | | 73,107 |
| Subtotal Department of Defense Direct Programs | | | \$ 160,510 |
| Department of Defense Pass-Through Programs From: XYZ Labs—Effects of Ice on Radar Images | 12.UNKNOWN | 4532 | \$ 11,987 |
| Total Department of Defense | | | \$ 172,497 |
| National Science Foundation Direct Programs | | | |
| Geosciences | 47.050 | | \$ 358,245 |
| Biological Sciences | 47.074 | | 96,543 |
| Subtotal National Science Foundation Direct Programs | | | \$ 454,788 |
| National Science Foundation Pass-Through Programs From: ABC University—Atmospheric Effects of Volcano Eruptions | 47.ABC-852 | ABC-852 | 25,987 |
| Total National Science Foundation | | | \$ 480,775 |
| Department of Health and Human Services: | | | |
| National Institutes of Health Direct Programs | | | |
| Mental Health Research Grants | 93.242 | | \$ 110,499 |
| Drug Abuse and Addiction Research Programs | 93.279 | | 89,075 |
| National Institutes of Health Pass-Through Programs From: ABC Hospital—Heart Research | 93.UNKNOWN | 5489-5 | 230,433 |
| Centers for Disease Control and Prevention Direct Programs Chronic Diseases: Research, Control, and Prevention | 93.068 | | 112,446 |
| Total Department of Health and Human Services | | | \$ 542,453 |

¹⁴ For research and development, Circular A-133 states that total federal awards expended should be shown either by individual award or by federal agency and major subdivision within the federal agency. This example illustrates the individual award option.

| <i>Federal Grantor/Pass-Through Grantor/Program or Cluster Title</i> | <i>Federal CFDA Number</i> | <i>Pass-Through Entity Identifying Number</i> | <i>Federal Expenditures</i> |
|------------------------------------------------------------------------------------|--------------------------------|-----------------------------------------------------------|---------------------------------|
| <i>Total Research and Development Cluster</i> | | | \$ 1,195,725 |
| <i>Trio Cluster</i> | | | |
| Department of Education Direct Programs | | | |
| TRIO—Talent Search | 84.044 | | \$ 308,465 |
| TRIO—Upward Bound | 84.047 | | 78,654 |
| <i>Total TRIO Cluster</i> | | | \$ 387,119 |
| <i>Other Programs</i> | | | |
| Department of State Direct Programs | | | |
| Educational | | | |
| Exchange—University Lectures (Professors) and Research Scholars (note 4) | 19.401 | | \$ 17,823 |
| <i>Total Department of State Direct Programs</i> | | | \$ 17,823 |
| Department of Education Direct Programs | | | |
| Safe and Drug-Free Schools and Communities—National Programs | 84.184 | | \$ 59,723 |
| Undergraduate International Studies and Foreign Language Programs | 84.016 | | 34,688 |
| Subtotal Department of Education Direct Programs | | | \$ 94,411 |
| Department of Education Pass-Through Programs From: | | | |
| State Department of Education—Vocational Education Basic Grants to States | 84.048 | 874-90-5473 | \$ 3,115 |
| State Department of Education—Tech-Prep Education | 84.243 | 25-8594-2167 | 176,885 |
| Subtotal Department of Education Pass-Through Programs | | | \$ 180,000 |
| <i>Total Department of Education</i> | | | \$ 274,411 |
| <i>Total Expenditures of Federal Awards</i> | | | \$13,857,776 |

The accompanying notes are an integral part of this schedule.

Example Entity University
Notes to the Schedule of Expenditures of Federal Awards
For the Year Ended June 30, 20X1

Note 1. Basis of Presentation¹⁵

The accompanying schedule of expenditures of federal awards (the "Schedule") includes the federal grant activity of Example Entity University under programs of the federal government for the year ended June 30, 20X1. The information in this schedule is presented in accordance with the requirements of the Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Government, and Non-Profit Organizations*. Because the schedule presents only a selected portion of the operations of Example Entity University, it is not intended to and does not present the financial position, changes in net assets or cash flows of Example Entity University.

Note 2. Summary of Significant Accounting¹⁶

Expenditures reported on the schedule are reported on the (identify basis of accounting) basis of accounting. Such expenditures are recognized following the cost principles contained in OMB Circular A-21, *Cost Principles for Education Institutions*, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Negative amounts shown on the schedule represent adjustments or credits made in the normal course of business to amounts reported as expenditures in prior years. Pass-through entity identifying numbers are presented where available.

Note 3. Federal Student Loan Programs¹⁷

The federal student loan programs listed subsequently are administered directly by Example Entity University and balances and transactions relating to these programs are included in Example Entity University's basic financial statements. Loans made during the year are included in the federal expenditures presented in the schedule. The balance of loans outstanding at June 30, 20X1 consists of:

| <i>CFDA Number</i> | <i>Program Name</i> | <i>Outstanding Balance at June 30, 20X1</i> |
|--------------------|----------------------------------|-----------------------------------------------------|
| 84.038 | Perkins Loan Program | \$6,341,180 |
| 93.364 | Nursing Student Loans | \$3,815,635 |
| 93.342 | Health Professions Student Loans | \$4,353,248 |

¹⁵ See footnote 5.

¹⁶ See footnote 6.

¹⁷ This note is intended to meet the Circular A-133 requirement that loans or loan guarantees outstanding at year end be included in the schedule. The basis used to determine loans or loan guarantees expended is the amount of new loans made or received during the fiscal year plus the balance of loans from previous years for which the federal government imposes continuing compliance requirements, plus any interest subsidy, cash, or administrative cost allowance received. See table 7-2 and paragraph 7.20 for more discussion of loans and loan guarantees.

Note 4. Subrecipients¹⁸

Of the federal expenditures presented in the schedule, Example Entity University provided federal awards to subrecipients as follows:

| <i>CFDA Number</i> | <i>Program Name</i> | <i>Amounts Provided to Subrecipients</i> |
|--------------------|------------------------------------------------------------------------------------------------------|----------------------------------------------|
| Various 19.401 | Research & Development Cluster Educational Exchange University Lecturers and Research Scholars | \$985,465 \$ 5,104 |

¹⁸ See footnote 6.

Appendix B—Schedule of Expenditures of Federal Awards Illustrative Tools^{*,1}

This appendix contains nonauthoritative, illustrative tools to assist auditors in determining whether the Schedule of Expenditures of Federal Awards (SEFA) includes the required elements, is accurate and complete, and that the auditor's procedures relating to the SEFA are appropriately documented.

The SEFA, which is prepared by the auditee and considered supplementary information, is an important part of the reporting package required by the Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133). The auditor is required by Circular A-133 to determine and provide an opinion on whether the SEFA is presented fairly in all material respects in relation to the auditee's financial statements as a whole. Further, the information in the SEFA serves as the primary basis for the auditor's major program determination, which is a key component of performing a single audit.

The two illustrative tools are as follows:

- **Audit Plan Supplement for the Schedule of Expenditures of Federal Awards in Accordance With OMB Circular A-133.** This illustrative audit plan is intended to provide the auditor with a tool to document the procedures performed for purposes of providing the in-relation-to opinion on the SEFA, as well as the additional procedures to determine the accuracy and completeness of the information included in the SEFA. Given both the in-relation-to opinion provided on the SEFA and the significance of the information in the SEFA to the auditor's major program determination, it is important for the auditor to clearly document the procedures performed on the SEFA. The suggested procedures were developed to be responsive to the following assertions: *completeness, occurrence, accuracy, cutoff, and classification and understandability*. Consideration of the facts and circumstances and risk assessment of their particular engagements will assist auditors in tailoring this illustrative audit plan to be responsive to identified risks.
- **Disclosure Checklist: Schedule of Expenditures of Federal Awards in Accordance With OMB Circular A-133.** This checklist is intended to assist the auditor in determining whether the auditee's SEFA includes all of the elements required by Circular A-133.

^{*} Note that these auditor tools do not contemplate any additional Schedule of Expenditures of Federal Awards (SEFA) or other auditee requirements relating to the Recovery Act. As noted in paragraph 7.26, consideration of the facts and circumstances of a particular engagement will assist auditors in tailoring this illustrative audit plan to be responsive to identified risks.

¹ Two additional illustrative tools are available online for auditees. The first is an illustrative worksheet for auditees to use to accumulate and document important information about their federal programs. The second is an illustrative auditee disclosure checklist for the SEFA. Because preparation of the SEFA is the auditee's responsibility, auditors may recommend that their clients refer to both of these tools. The auditee tools are available, at no charge, through the Governmental Audit Quality Center (GAQC) website under the link www.aicpa.org/InterestAreas/GovernmentalAuditQuality/Resources/AuditPracticeToolsAids/Pages/Single%20Audit%20Practice%20Aids.aspx.

These tools are intended to help auditors with audits in accordance with the Single Audit Act Amendments of 1996 and Circular A-133. Users of these nonauthoritative, illustrative tools should consult the original material referenced for a complete understanding of the standards, requirements, and guidance.

Audit Plan Supplement for the Schedule of Expenditures of Federal Awards in Accordance With OMB Circular A-133

Audit Objectives

Note: The letters preceding the audit objectives are identification codes. The objective column that follows (identified under the heading "Obj.") presents those codes when the audit step accomplishes or helps to accomplish the specific objective.

- A. To determine whether the schedule of expenditures of federal awards (schedule) is fairly stated in all material respects in relation to the basic financial statements.
- B. To determine whether the schedule provides an appropriate basis for determining major programs.

Assertions

Note: The letters preceding the assertions are identification codes. The assertion column that follows (identified under the heading "Assn." the follows) presents those codes when the audit step addresses or helps to address the specific assertion.

CM: Completeness:

All expenditures that should have been recorded have been recorded,
or

All disclosures that should have been included in the schedule have
been included.

OC: Occurrence:

Transactions and events that have been recorded have occurred and
pertain to the entity, or

Disclosed events and transactions have occurred and pertain to the
entity.

AC: Accuracy:

Amounts and other data relating to recorded transactions and events
have been recorded appropriately, or

Financial and other information are disclosed fairly and at the appro-
priate amounts.

CT: Cutoff:

Expenditures have been recorded in the correct period.

CU: Classification and Understandability:

Information is appropriately presented and described and disclosures
are clearly expressed.

Procedures Related to an in Relation to Report²

| Obj. | Assn. | | Initials | Date | Ref. |
|------|----------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|-------|-------|
| A. | | 1. Obtain the current-year schedule of expenditures of federal awards (which may only be available in draft form) and perform the following procedures to determine whether the information is fairly stated, in all material respects, in relation to the financial statements as a whole: | | | |
| | AC, CU | a. Inquire of management whether the schedule was prepared in accordance with Circular A-133. | _____ | _____ | _____ |
| | AC, CU | b. Obtain an understanding about the methods of preparing the information, including whether the form and content complies with Circular A-133. | _____ | _____ | _____ |
| | CM, OC, AC, CT | c. Compare and reconcile information to the underlying accounting and other records used in preparing the financial statements or to the financial statements themselves. | _____ | _____ | _____ |
| | AC, CT, CU | d. Inquire of management whether there were any significant assumptions or interpretations underlying the measurement of presentation of the information. | _____ | _____ | _____ |

² Statement on Auditing Standards (SAS) No. 119, *Supplementary Information in Relation to the Financial Statements as a Whole* (AICPA, *Professional Standards*, vol. 1, AU sec. 551), was issued in February 2010. This SAS addresses and clarifies the auditor's responsibility when engaged to opine on whether other information is fairly stated, in all material respects, in relation to the financial statements as a whole. SAS No. 119 is effective for audit engagements for periods beginning on or after December 15, 2010, with early application permitted. The steps related to objective A of this audit plan will be revised for the guidance in SAS No. 119, as appropriate, in a future edition of the guide.

| <u>Obj.</u> | <u>Assn.</u> | | <u>Initials</u> | <u>Date</u> | <u>Ref.</u> |
|-------------|--------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------|-------------|-------------|
| | CM, OC, AC | e. Evaluate the appropriateness and completeness of the information, considering procedures and other knowledge obtained during the audit of the financial statements. | _____ | _____ | _____ |
| | CM, OC, AC, CT, CU | 2. Obtain the following written representations from management: | | | |
| | | a. That it acknowledges its responsibility for the information; | _____ | _____ | _____ |
| | | b. That the form and content of the schedule is in accordance with Circular A-133 §310.b; | _____ | _____ | _____ |
| | | c. That the methods of measurement or presentation have not changed from those used in the prior period or, if the methods of measurement have changed, the reasons for such changes; and | _____ | _____ | _____ |
| | | d. As to any significant assumptions underlying the measurement or presentation of the schedule. | _____ | _____ | _____ |
| | | 3. Document following our conclusion whether the schedule is fairly presented in relation to the basic financial statements as a whole. | _____ | _____ | _____ |

Procedures Related to Major Program Determination and Other Circular A-133 Requirements

| <i>Obj.</i> | <i>Assn.</i> | | <i>Initials</i> | <i>Date</i> | <i>Ref.</i> |
|-------------|-------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------|-------------|-------------|
| B. | | 4. Obtain the current-year schedule of expenditures of federal awards (which may only be available in draft form), perform procedures to validate the amounts in the schedule: | | | |
| | CM, OC, AC, CU | a. Obtain an understanding of internal control over the preparation of the schedule. This would include the following: | | | |
| | | (1) Controls over completeness and accuracy | _____ | _____ | _____ |
| | | (2) Controls that ensure Catalog of Federal Domestic Assistance (CFDA) numbers are correct | _____ | _____ | _____ |
| | CU | b. Determine whether the period covered by the schedule is the same as that covered by the financial statements. | _____ | _____ | _____ |
| | AC, CU | c. Determine whether the clusters reported in the schedule are correct by comparison to Part 5 of the <i>Compliance Supplement</i> | _____ | _____ | _____ |
| | | d. Test completeness of the schedule through various procedures, such as | | | |
| | CM, OC, AC, CT | (1) reconciling to the underlying accounting records and/or comparing to grant records; | _____ | _____ | _____ |

| <u>Obj.</u> | <u>Assn.</u> | | <u>Initials</u> | <u>Date</u> | <u>Ref.</u> |
|-------------|------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------|-------------|-------------|
| | CM, OC, AC | (2) comparison to prior year schedule; and | _____ | _____ | _____ |
| | CM, OC, AC | (3) noting consistency with other knowledge obtained during audit procedures performed during the financial statement audit, and audit procedures performed during the compliance portion of the single audit. | _____ | _____ | _____ |
| | | 5. Test accuracy of CFDA numbers and names of awarding agencies by comparison to various source and other documents, such as | | | |
| | AC, CU | a. <i>Compliance Supplement</i> ; | _____ | _____ | _____ |
| | AC, CU | b. CFDA website for accuracy of CFDA number and name of awarding agency; | _____ | _____ | _____ |
| | AC, CU | c. Appendix VII of the CFDA, Historical Profile of Catalog Programs, where applicable; and | _____ | _____ | _____ |
| | AC, CU | d. Underlying grant records. | _____ | _____ | _____ |
| | | 6. Determine whether the schedule: | | | |
| | CU, AC | a. Properly identifies federal awards from pass-through entities and the federal portion of multifunded awards, and assess potential finding if client is unable to determine these amounts. | _____ | _____ | _____ |

(continued)

| <i>Obj.</i> | <i>Assn.</i> | | <i>Initials</i> | <i>Date</i> | <i>Ref.</i> |
|-------------|-------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------|-------------|-------------|
| | CM, OC, AC | b. Properly includes direct and indirect costs, and excludes cost sharing or matching amounts. | _____ | _____ | _____ |
| | CU, CM, OC, AC | c. Presents the minimum data elements required by A-133, Section 310(b). ³ | _____ | _____ | _____ |
| | CU | d. Presents in the notes to the schedule the significant accounting policies used and basis of presentation. | _____ | _____ | _____ |
| | AC, CM, OC | e. Appropriately measures certain specific items, such as loans and loan guarantees, endowment funds, and noncash assistance, as provided in A-133, Section 205(b)–(j). | _____ | _____ | _____ |
| | CU, AC | f. Uses measurements or presentations that differ from those in the prior period. (If so, evaluate the nature and reasonableness of the changes.) | _____ | _____ | _____ |
| | CU, CT, AC | g. Has any significant assumptions or interpretations underlying the measurements or presentations. (If so, evaluate the appropriateness of those assumptions and interpretations.) | _____ | _____ | _____ |

³ Auditors may refer to the illustrative tool developed by the GAQC titled *Disclosure Checklist—Schedule of Expenditures of Federal Awards in Accordance with OMB Circular A-133* (which follows in this appendix) for assistance with this procedure.

| <u>Obj.</u> | <u>Assn.</u> | | <u>Initials</u> | <u>Date</u> | <u>Ref.</u> |
|-------------|--------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------|-------------|-------------|
| | CM, OC, AC, CT, CU | 7. In addition to the management representations discussed in step 2, obtain the following written representations from management: | | | |
| | | a. That it is management's responsibility for understanding and complying with the compliance requirements related to the preparation of the schedule. | _____ | _____ | _____ |
| | | b. That management has identified all of its government programs and related activities subject to Circular A-133 and has included expenditures made during the period being audited for all awards provided by federal agencies in the form of grants, federal cost-reimbursement contracts loans, loan guarantees, property (including donated surplus property), cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, and other direct assistance. | _____ | _____ | _____ |
| | | c. That management has made available all contracts and grant agreements, including amendments, if any, and any other correspondence that have taken place with federal agencies or pass-through entities related to federal programs. | _____ | _____ | _____ |

(continued)

| <u>Obj.</u> | <u>Assn.</u> | | <u>Initials</u> | <u>Date</u> | <u>Ref.</u> |
|-------------|--------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------|-------------|-------------|
| | | d. Acknowledges management's responsibility for establishing and maintaining controls that provide reasonable assurance that the entity manages government programs in compliance requirements. | _____ | _____ | _____ |
| | | 8. Evaluate identified control weaknesses pertaining to the auditee's complete and accurate schedule and determine whether such deficiencies individually or in combination, are significant deficiencies or material weaknesses relating to internal control over financial reporting, internal control over compliance or both. | _____ | _____ | _____ |

Conclusion: In our opinion, the objectives of this audit plan have been met, except as follows: _____

We have completed this audit plan supplement in accordance with firm policy.

Prepared by: _____ Date: _____

Reviewed by: _____ Date: _____

Disclosure Checklist: Schedule of Expenditures of Federal Awards in Accordance With OMB Circular A-133

| | <i>Not Applicable N/A</i> | <i>Yes/No (Y, N)</i> |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------|--------------------------|
| 1. Does the schedule | | |
| a. list individual federal programs by federal agency? | _____ | _____ |
| b. show total federal awards expended for each individual federal program and include the CFDA number? | _____ | _____ |
| c. if a CFDA number is not available, include another identifying number and the name of the program? ⁴ | _____ | _____ |
| d. list individual awards within a cluster of programs? | _____ | _____ |
| e. for research and development (R&D), list federal awards expended either by individual award or by federal agency and major subdivision within the federal agency? | _____ | _____ |
| f. identify, to the extent practical, the total amount provided to subrecipients from each federal program (or alternatively may be included in the notes)? | _____ | _____ |
| g. include, if applicable, for federal awards received as subrecipient, the name of the pass-through entity and identifying number assigned by the pass-through entity? | _____ | _____ |

(continued)

⁴ When the Catalog of Federal Domestic Assistance (CFDA) number is not available, the auditee has alternatives for presenting that information. The auditee could indicate that the CFDA number is not available and include, if available, another identifying number, such as a contract or grant number. The auditee also could apply the guidance presented in the Federal Audit Clearinghouse's data collection form instructions for when a federal program does not have a CFDA number. Specifically, if the program has a contract or grant number, the number shown as the CFDA number could be the awarding agency's 2-digit prefix listed for the agency in the appendix to the forms' instructions (or 99 if the agency is not listed) followed by the contract or grant number. If the program does not have a contract or grant number, the number shown as the CFDA number could be awarding agency's 2-digit prefix (or 99) followed by "UNKNOWN."

| | <i>Not Applicable N/A</i> | <i>Yes/No (Y, N)</i> |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------|--------------------------|
| 2. Does the schedule include notes that appropriately and completely describe the significant accounting policies used in preparing the schedule and basis of accounting? | | |
| 3. Does the schedule (preferably) or a note to the schedule include the value of the Federal awards expended in the form of | | |
| a. noncash assistance? | | |
| b. the amount of insurance in effect during the year? | | |
| c. the amount of loans or loan guarantees (including interest subsidies) outstanding at year end? | | |
| 4. While not required by Circular A-133, does the schedule include additional information required by federal awarding agencies and pass-through entities? | | |
| 5. To the extent non-federal awards are presented in the schedule, is the data clearly segregated and designated as non-federal along with a modification of the title to indicate the inclusion of non-federal awards? | | |

Conclusion: The schedule of expenditures of federal awards presents the minimum data elements required by the Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, Section 310(b).

Comments concerning any "no" answers above:_____

Item Number

*Audit Documentation
Reference*

Reference to schedule of expenditures of federal awards:

We have completed this checklist in accordance with firm policy:

| <i>Initials</i> | <i>Date</i> |
|-----------------|-------------|
| <hr/> | <hr/> |

Prepared by:

Reviewed by:

Chapter 8

Determination of Major Programs

Note: The audit required by the Single Audit Act Amendments of 1996 and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, should be performed in accordance with *Government Auditing Standards*. Part I, "Government Auditing Standards Audits," (chapters 2–4 of this guide) discusses financial statement audits under generally accepted auditing standards (GAAS) and *Government Auditing Standards*. The guidance in parts I and II, "Circular A-133 Audits," (chapters 5–14 of this guide) is applicable for those auditors performing an audit under the Single Audit Act Amendments of 1996 and Circular A-133.

Information related to the American Recovery and Reinvestment Act of 2009 (Recovery Act) can be found in a section located at the end of each chapter in part II of this guide. See the section titled "American Recovery and Reinvestment Act Considerations" beginning at paragraph 8.38 in this chapter. See also the preface section titled "Impact of the American Recovery and Reinvestment Act of 2009 on Single Audits."

Introduction¹

8.01 Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133), states that the auditee should identify in its accounts all federal awards received and expended and the federal programs under which they were received. The auditee should also prepare a schedule of expenditures of federal awards for the period covered by its financial statements. (Chapter 7, "Schedule of Expenditures of Federal Awards," of this guide discusses the requirements related to that schedule.) However, Circular A-133 places the responsibility for identifying major programs on the auditor, and it provides the criteria to be used in applying a risk-based approach to determining major programs. The risk-based approach is designed to focus the Circular A-133 compliance audit on higher-risk programs. Paragraph 8.24 discusses when the auditor can deviate from the use of risk criteria.

8.02 The auditor's determination of the programs to be audited is based on an evaluation of the risks of noncompliance occurring that could be material to an individual major federal program. In evaluating such risks, the auditor

¹ As noted in Statement on Auditing Standards (SAS) No. 117, *Compliance Audits* (AICPA, *Professional Standards*, vol. 1, AU sec. 801), the auditor should determine whether audit requirements are specified in a governmental audit requirement that are supplementary to generally accepted auditing standards and *Government Auditing Standards* and perform procedures to address those requirements, if any. In providing examples of supplementary audit requirements, SAS No. 117 identifies procedures performed in an Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133), audit to identify major programs.

considers, among other things, the current and prior audit experience with the auditee, the oversight exercised by federal agencies and pass-through entities, and the inherent risk of noncompliance of the federal programs. The auditor should use professional judgment and the guidance in Sections 520, 525, and 530 of Circular A-133 in the risk assessment process. In addition, the auditor may find it helpful to discuss the nature of federal programs with the management of the auditee and the federal or state agency that provided the funds to the auditee. (See chapter 6, "Planning Considerations of Circular A-133," of this guide for a related discussion.)

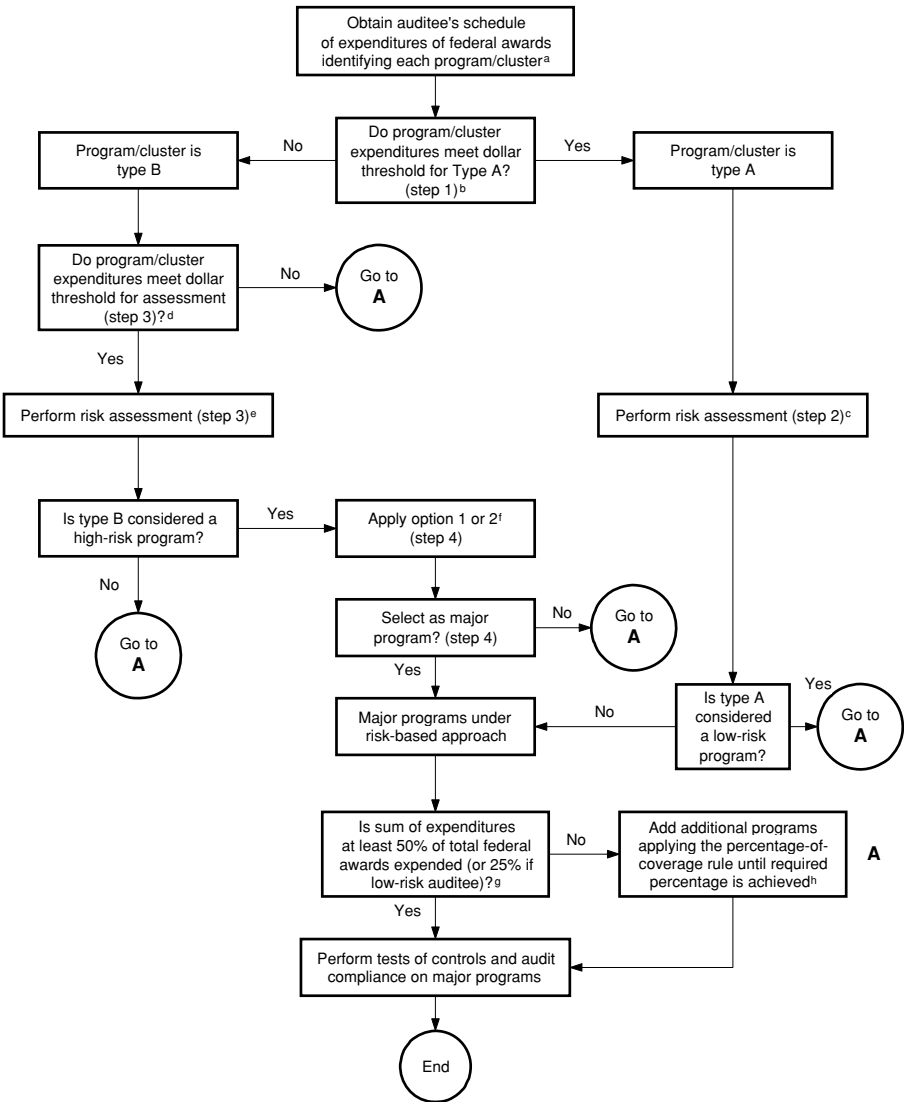
Applying the Risk-Based Approach

8.03 The guidance on the risk-based approach is organized here as provided in Circular A-133 and consists of the steps in the following listing. Exhibit 8-1 is a flowchart illustrating the application of the risk-based approach for determining major programs.

- Step 1—Determination of type A and type B programs (paragraphs 8.04–.10)
- Step 2—Identification of low-risk type A programs (paragraphs 8.11–.14)
- Step 3—Identification of high-risk type B programs (paragraphs 8.15–.17)
- Step 4—Determination of programs to be audited as major (paragraphs 8.18–.20)

Exhibit 8-1

Flowchart Illustration of Applying the Risk-Based Approach for Determining Major Programs



- ^{fn a} Chapter 5, "Overview of the Single Audit Act, Circular A-133, and the *Compliance Supplement*," of this guide defines federal programs, including clusters.
- ^{fn b} paragraphs 8.04–.10 discuss step 1.
- ^{fn c} paragraphs 8.11–.14 discuss step 2.
- ^{fn d} paragraphs 8.15–.17 discuss step 3.
- ^{fn e} Before performing the risk assessment, this guide recommends the auditor consider whether option 1 or option 2 will be selected under step 4 because it will affect whether risk assessments need to be performed on all type B programs or only some type B programs. See paragraph 8.16.
- ^{fn f} The number of type B high-risk programs identified as major programs is either of the following:
- *Option 1.* One-half of the number of type B high-risk programs, unless this number exceeds the number of low-risk type A programs identified in step 2. In this case, the auditor would be required to audit as major the same number of high-risk type B programs as low-risk type A programs. Under this option, the auditor is expected to perform risk assessments on all type B programs that exceed the threshold for type B.
 - *Option 2.* One high-risk type B program for each low-risk type A program. This option does not require the auditor to perform risk assessments on all type B programs. Paragraphs 8.18–.20 discuss step 4, including option 1 and option 2.
- ^{fn g} There may be instances when the auditee includes certain noncash assistance (such as loan guarantees or loans) in the notes to the schedule of expenditures of federal awards. (See chapter 7 of this guide.) Federal non-cash assistance is included as part of total federal awards expended when performing this calculation.
- ^{fn h} The additional programs/clusters selected (marked "A" on the flowchart) to meet the percentage-of-coverage rule are audited as major programs in addition to type A and type B programs identified in steps 1–4. Paragraph 8.21 discusses the percentage-of-coverage rule.

Step 1—Determination of Type A and Type B Programs

8.04 To determine which federal programs are to be audited as major (see step 4), the auditor should first identify federal programs as being either type A or type B as defined in Circular A-133. In general, type A programs are larger federal programs and type B programs are smaller federal programs. The schedule of expenditures of federal awards, prepared by the auditee, provides important program information and assists the auditor with the identification of type A and type B programs. Federal awards expended for purposes of determining type A and type B programs are the amount of cash and noncash awards, after all adjustments are made, in the *final* current-year schedule of expenditures of federal awards, including the notes thereto. An auditor who uses the prior-year schedule or preliminary current-year estimates to plan the audit should recalculate the threshold for type A programs based on the final amounts to ensure that federal awards are properly classified as type A or B. (For purposes of determining major programs, a cluster of programs should

be considered as one program. Chapter 5 of this guide discusses clusters of programs.)

Type A Program Criteria

8.05 The larger federal programs are labeled as type A. Table 8-1 presents the criteria that Circular A-133 establishes for identifying type A programs.

Table 8-1

Criteria for Identifying Type A Programs

| <i>When Total Federal Awards Expended¹ Are</i> | <i>A Type A Program Is Any Program With Federal Awards Expended That Exceed the Larger of—</i> |
|-------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------|
| More than or equal to \$300,000 and less than or equal to \$100 million | \$300,000 or 3% (0.03) of federal awards expended |
| More than \$100 million and less than or equal to \$10 billion | \$3 million or 0.3% (0.003) of federal awards expended |
| More than \$10 billion | \$30 million or 0.15% (0.0015) of federal awards expended |

¹ Includes both cash and noncash awards.

Type B Program Criteria

8.06 Federal programs that do not meet the type A criteria are considered type B programs.

Effect of Large Loans and Loan Guarantees on Identification of Type A Programs

8.07 Chapter 7 of this guide discusses the various types of noncash awards, including loans and loan guarantees, and when they are recognized as expended and how they are valued for purposes of the Circular A-133 audit. Circular A-133 states that when the auditor applies the dollar criteria shown in table 8-1 to identify type A programs, the inclusion of large loans and loan guarantees should not result in the exclusion of other federal programs as type A programs. (This requirement relates only to loans and loan guarantees and not to any other large noncash federal awards.) When a federal program providing loans or loan guarantees significantly affects the number or size of type A programs, the auditor should consider the loan or loan guarantee program a type A program and exclude its value in determining other type A programs.

8.08 The OMB has issued clarifying guidance related to this issue in the 2010 *OMB Circular A-133 Compliance Supplement*^{*} (*Compliance Supplement*) as found in the section titled "Safe Harbor for Treatment of a Large Loan and Loan Guarantee Programs in Type A Program Determination of Appendix 7, Other OMB Circular A-133 Advisories." This guidance states that in order to

^{*} At the time of this writing, the OMB 2010 *OMB Circular A-133 Compliance Supplement* (*Compliance Supplement*) is expected to include the information contained in this section. It is important that readers be alert to final issuance of the *Compliance Supplement*, which will be available on the OMB website at www.whitehouse.gov/omb/grants_circulars/.

promote consistency of practice, auditors may consider the following as a "safe harbor" for treatment of large loan and loan guarantee programs in determining type A programs when planning audits:

- a. Each individual loan and loan guarantee program (the program consists of the loans and other program expenditures as described in .205(b) of Circular A-133) that does not exceed 4 times the largest nonloan program (a cluster of programs is treated as 1 program) is not considered to be large. The presumption is that only changes in the number or size of type A programs that result from the exclusion of individual loan and loan guarantee programs that are in excess of 4 times that of the largest nonloan program are significant.
- b. Auditors are only required to perform the recalculation of the type A threshold described in .520(b)(3) of Circular A-133 when the expenditures for a loan or loan guarantee program is more than 4 times that of the largest nonloan program (a cluster of programs is treated as one program).
- c. The recalculation is performed after removing the total of all large loan and loan guarantee programs.

8.09 Paragraph 8.10 demonstrates this overall concept using the example programs in table 8-2 by showing the identification of type A programs as well as the effect of loans and loan guarantees on that identification process. (Note that this example does not fit the criteria necessary to utilize the safe harbor provision discussed in paragraph 8.08.)

Table 8-2
Identification of Type A Programs and the Effect of Loans and Loan Guarantees

| <i>Program / Federal Grantor</i> | <i>Federal Awards Expended (\$000)</i> |
|----------------------------------------------------------------------------------------------------------------|----------------------------------------|
| Cash program A—U.S. Department of Labor | \$1,335 |
| Cash program B—U.S. Department of Health and Human Services | 3,000 |
| Cash program C-1—U.S. Department of Education | 175 |
| Cash program C-2—U.S. Department of Education | 280 |
| Cash program D—U.S. Department of Housing and Urban Development (a pass-through grant from a local government) | 310 |
| Subtotal—Cash federal awards expended | \$5,100 |
| Commodities program E—U.S. Department of Agriculture (a pass-through grant from a state) | 2,000 |
| Subtotal—Cash and commodities federal awards expended | \$7,100 |
| Loan program F—U.S. Department of Housing and Urban Development | 33,500 |
| Loan guarantee program G—U.S. Department of Agriculture | 57,000 ¹ |
| Total federal awards expended | \$97,600 |

¹ In accordance with Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, loans and loan guarantees include new loans made during the year, plus prior-year loans for which the federal government imposes continuing compliance requirements, plus any interest subsidy, cash, or administrative cost allowance received. Chapter 7, "Schedule of Expenditures of Federal Awards," of this guide provides additional information.

8.10 Table 8-2 shows that the auditee has \$97,600,000 in total federal awards expended. Therefore, applying the criteria in table 8-1 indicates that type A programs would be those that expended federal awards equal to or greater than \$2,928,000 (3 percent of \$97,600,000), or programs B, F, and G. However, when large loan and loan guarantee programs F and G are excluded from the base amount of the total federal awards expended in the calculation, the type A programs would be those programs that expended federal awards greater than \$300,000 (the larger of \$213,000 [3 percent of \$7,100,000] or \$300,000). Therefore, under the second calculation, programs A, B, D, E, F, and G would be type A programs. If the auditor, in his or her professional judgment, concludes that the difference in the number or size of type A programs is significantly affected by the inclusion of the loans and loan guarantees (which in this example would be likely due to the significant increase in type A programs), the auditor would identify programs A, B, D, E, F, and G as type A programs. The auditor could consider contacting the cognizant or oversight agency for audit if the auditor is unsure about whether to exclude loan or loan guarantees when determining type A programs.

Step 2—Identification of Low-Risk Type A Programs

8.11 After completing step 1, the auditor should perform a risk assessment of each type A program to identify those that are low risk. Circular A-133 includes certain conditions that, when met, indicate that a type A program may be low risk.

General Conditions for Low-Risk Type A Programs

8.12 Type A programs generally may be considered low risk if both of the following conditions are met: (a) the program has been audited as a major program in at least one of the two most recent audit periods (in the most recent audit period in the case of a biennial audit) and (b) in the most recent audit period, the program had no audit findings. (Chapter 13, "Auditor Reporting Requirements and Other Communication Considerations in a Single Audit," of this guide discusses the situations that Circular A-133 requires the auditor to report as audit findings.) It is important for auditors to note that every type A program that was not audited in one of the two prior years should be audited as a major program. If a type A program is new to an entity in the current year (for example, because the entity did not previously participate in the program or because it is a new federal program), it should be audited as a major program in the current year because it was not audited in one of the prior two years. If a program that previously was a type B program is a type A program in the current year (for example, because the funding level increased), and the program was not audited as a major program in one of the two prior years, it should be audited as a major program in the current year. Auditor judgment, as discussed in paragraph 8.13, cannot override the requirement that major

programs should include every type A program that (a) was not audited in one of the two prior years or (b) had audit findings other than those indicated in paragraph 8.13.

Auditor Judgment in Determination of Low-Risk Type A Programs

8.13 Circular A-133 permits the auditor to conclude, based on professional judgment, that a type A program is low risk even though in the prior audit period (a) it may have had known or likely questioned costs greater than \$10,000 for a type of compliance requirement, (b) known fraud has been identified, or (c) the summary schedule of prior audit findings materially misrepresents the status of a prior audit finding. (The auditor cannot conclude, based on professional judgment, that a type A program is low risk if there were other types of audit findings, such as significant deficiencies in internal control over compliance or material noncompliance.) For example, consider a situation in which the funds expended under a federal program in the prior year totaled \$10 million, there were known questioned costs of \$11,000 that related to one isolated instance, and there were no additional likely questioned costs. In this example, the auditor, based on professional judgment, could decide that the program is low risk in the current year. In making the final determination of whether a type A program is low risk, the auditor should also consider the risk criteria in paragraphs 8.27–37, the results of audit follow-up, and whether any changes in the personnel or systems affecting a type A program have significantly increased its risk. Based on all of this information, the auditor would apply professional judgment in determining whether a type A program is low risk.

Type A Program Not Considered Low Risk at Request of Federal Awarding Agency

8.14 Section 520(c)(2) of Circular A-133 permits a federal awarding agency to request that a type A program for certain recipients not be considered low risk so that it would be audited as a major program. For example, it may be necessary for a large type A program to be audited as major each year for particular recipients to allow the federal agency to comply with the Government Management Reform Act of 1994. In this instance, Circular A-133 requires the federal awarding agency to obtain approval from the OMB. (The OMB has not yet made any such approvals.) Furthermore, the federal awarding agency should notify the recipient and, if known, the auditor at least 180 days before the end of the fiscal year end to be audited. (Paragraph 8.36 discusses the federal agency option to identify federal programs as higher risk in the *Compliance Supplement*.)

Step 3—Identification of High-Risk Type B Programs

8.15 After completing steps 1–2, the auditor should identify type B programs that are high risk, using professional judgment and the risk criteria discussed in paragraphs 8.27–37. Except for known significant deficiencies in internal control over compliance or instances of noncompliance, a single risk criterion would, in general, seldom cause a type B program to be considered high risk.

8.16 Before beginning step 3, this guide recommends the auditor

- consider whether there are low-risk type A programs. When there are no type A programs identified as low risk (either because there are no type A programs or because none of the type A programs are low risk), the auditor is not required to perform step 3. If there

are no type A programs, the auditor would audit as major enough type B programs to meet the percentage-of-coverage rule (see paragraph 8.21). When there are type A programs, but none are low risk, the auditor would audit as major all type A programs plus any additional type B programs needed to meet the percentage-of-coverage rule. In either case, any programs requested to be audited by a federal agency or pass-through entity should be audited as a major program and would be included in determining whether the percentage-of-coverage rule has been met (see paragraph 8.25).

- consider whether option 1 or option 2 will be used in step 4. (Paragraphs 8.19–20 describe each option.) The auditor's decision of which option to choose will likely be based on audit efficiency and will affect how many type B programs are subject to risk assessment. This guide recommends that the auditor consider the following discussion before deciding whether to use option 1 or option 2:
 - Under option 1, the auditor should perform a risk assessment on all type B programs (excluding small type B programs as discussed in paragraph 8.17). In comparison with option 2, option 1 will likely require the auditor to perform more type B program risk assessments, but may also result in the auditor having to audit fewer major programs. For example, assume that an auditee has 4 low-risk type A programs and 10 type B programs that exceed the amount specified in table 8-3. Also assume that the auditor chooses option 1. In this scenario, the auditor would be required to perform a risk assessment on all type B programs. If the auditor finds that only four type B programs are high risk, the auditor would be required to audit only two of the four high-risk type B programs as major (one-half of the number of high-risk type B programs).
 - Under option 2, the auditor should identify high-risk type B programs up to the number of low-risk type A programs. In comparison with option 1, option 2 will likely require the auditor to perform fewer type B risk assessments, but may also result in the auditor having to audit more major programs. For example, assume that an auditee has 4 low-risk type A programs and 10 type B programs that exceed the amount specified in table 8-3. Assume also that the first four type B programs subject to risk assessment are determined by the auditor to be high risk. In this scenario, the auditor may choose option 2, identify the four high-risk type B programs as major, and not perform risk assessments on the remaining six type B programs. Using the same example but assuming that the auditee only has one low-risk type A program (instead of four), the auditor would be required to audit one type B program as major under either option 1 or 2. In this scenario, option 2 would likely be the most efficient choice for the auditor because the auditor would only need to perform type B program risk assessments until one high-risk type B program was identified (under option 1 the auditor would be required to perform a risk assessment on all type B programs).

Criteria for Performing Risk Assessments on Type B Programs

8.17 An auditor is not expected to perform risk assessments on relatively small federal programs. Therefore, Circular A-133 only requires the auditor to perform risk assessments on type B programs that exceed the larger of the criteria shown in table 8-3.

Table 8-3

| Criteria for Performing Risk Assessments on Type B Programs | |
|-------------------------------------------------------------------------|-------------------------------------------------------------------------------|
| <i>When Total Federal Awards Expended¹ Are—</i> | <i>Perform Risk Assessment for Type B Programs That Exceed the Larger of—</i> |
| More than or equal to \$300,000 and less than or equal to \$100 million | \$100,000 or 0.3% (0.003) of federal awards expended |
| More than \$100 million | \$300,000 or 0.03% (0.0003) of federal awards expended |

¹ Includes both cash and noncash awards.

Step 4—Determination of Programs to Be Audited as Major

Criteria for Major Programs

8.18 After completing steps 1–3, the auditor identifies the major programs. At a minimum, Circular A-133 states that the auditor should audit all of the following as major programs:

- All type A programs, except those identified as low risk under step 2 (see paragraphs 8.11–.14)
- High-risk type B programs as identified under either of the two options described in paragraphs 8.19–.20
- Programs to be audited as major based on a federal agency request (in lieu of the federal agency conducting or arranging for additional audits; paragraph 8.25 provides further information)
- Additional programs, if any, that are necessary to meet the percentage-of-coverage rule described in paragraph 8.21

Two Options Available for Identifying High-Risk Type B Programs

8.19 Section 520(e)(2) of Circular A-133 provides two options for identifying high-risk type B programs:

- *Option 1.* Under option 1, the auditor should perform risk assessments of all type B programs that exceed the amount specified in table 8-3, and to audit at least one-half of the high-risk type B programs as major, unless this number exceeds the number of low-risk type A programs identified in step 2 (that is, the cap). In this case, the auditor would be required to audit as major the same number of high-risk type B programs as the cap. For example, consider an auditee that has 10 low-risk type A programs, and 50 type B programs above the amount specified in table 8-3. Under this

option, the auditor would be required to perform risk assessments of the 50 type B programs. Assume that based on that assessment, the auditor determines that there are 25 high-risk type B programs. One-half of the 25 high-risk type B programs is 12.5, which rounds up to 13 programs. Under this option, the auditor would audit 13 of the high-risk type B programs as major; however, because the cap in this example is 10 (that is, the number of low-risk type A programs), the auditor is required to audit only 10 high-risk type B programs as major.

- *Option 2.* Under option 2, the auditor should audit as major only one high-risk type B program for each type A program identified as low risk in step 2. Under this option the auditor would not be required to perform risk assessments for any type B program when there are no low-risk type A programs (that is, the cap is zero). Continuing with the previous example, under option 2 the auditor would perform risk assessments of type B programs until 10 high-risk programs are identified (that is, 10 is the number of low-risk type A programs). The auditor would then audit as major the 10 type B programs identified as high risk. Depending on the order in which risk assessments on type B programs are performed, the auditor might only need to perform risk assessments of 10 type B programs determined to be high risk, or the auditor may need to perform risk assessments on additional type B programs until 10 high-risk programs are identified.

8.20 The auditor may choose option 1 or option 2. There is no requirement to justify the reasons for selecting either option. The results under options 1 and 2 may vary significantly, depending on the number of low-risk type A programs and high-risk type B programs (see paragraph 8.16). Circular A-133 encourages the auditor to use an approach that provides an opportunity for different high-risk type B programs to be audited as major over a period of time.

Percentage-of-Coverage Rule²

8.21 Circular A-133 states that the auditor should audit, as major programs, federal programs with federal awards expended that, in the aggregate, encompass at least 50 percent of the total federal awards expended. However, if the auditee meets the criteria for a low-risk auditee (see paragraph 8.26), the auditor is required to audit as major programs federal programs with federal awards expended that, in the aggregate, encompass at least 25 percent of the total federal awards expended. A computation of the total federal awards expended for the major programs audited, determined under step 4, as a percentage of the total federal awards expended will indicate the percentage of coverage. If the total does not equal 50 percent (or 25 percent in the case of a low-risk auditee) of the total federal awards expended, the auditor should select additional programs (either type A or type B) to equal 50 percent (or 25 percent in the case of a low-risk auditee) and test them as major programs. The selection of additional programs to meet the percentage-of-coverage is based on the

² It is important to note that the percentage of coverage rule represents the minimum coverage to be achieved and is calculated after the determination of programs to be audited is made in step 4 (described in paragraphs 8.18–20). Once the initial determination of programs to be audited is made, the percentage of coverage rules determines if additional programs are required to be audited to meet the percentage of coverage threshold for the auditee.

auditor's professional judgment. When selecting additional programs to meet the percentage-of-coverage rule, the auditor may select programs without regard to risk assessment. If loans or loan guarantees are major programs, these programs may be used for purposes of meeting the percentage-of-coverage rule. Furthermore, when a federal agency or pass-through entity requests and pays for a program to be audited as major (see paragraph 8.25), that program may also be used for purposes of meeting the percentage-of-coverage rule.

Documentation of Risk Assessment

8.22 Circular A-133 states that the auditor should document the risk assessment process used in determining major programs. It is therefore necessary for the auditor to develop adequate audit documentation, as required by GAAS and *Government Auditing Standards*, and which includes documentation supporting the determination of major programs. (Chapter 2, "Planning Considerations of *Government Auditing Standards*," and chapter 6 of this guide discuss the audit documentation requirements of GAAS and *Government Auditing Standards*.)

Auditor Judgment in the Risk Assessment Process

8.23 Circular A-133 states that when the determination of major programs is performed and documented by the auditor in accordance with the circular, the auditor's judgment in applying the risk-based approach to determine major programs is presumed correct. Challenges by federal agencies and pass-through entities should be made only for clearly improper use of the guidance in Circular A-133. However, federal agencies and pass-through entities may provide the auditor with guidance about the risk of a particular federal program, which the auditor should consider when determining major programs.

Other Considerations Regarding the Risk-Based Approach

Deviation From Use of Risk Criteria

8.24 For first-year audits, Circular A-133 Section 520(h)(i) allows auditors to deviate from the previously described risk assessment process. A first-year audit is defined as the first year an entity is audited under Circular A-133 or as the first year of a change in auditors. This exception allows the auditor to elect to determine major programs as all type A programs plus any type B programs as are necessary to meet the percentage-of-coverage rule described in paragraph 8.21. Under this option, the auditor is not required to perform steps 2–4 as described in paragraphs 8.11–.20. However, to ensure that a frequent change of auditors would not preclude the audit of high-risk type B programs, this election for first-year audits may not be used more than once every three years. This guide recommends that auditors consider whether this exception is an option during the planning phase of the single audit. (Chapter 6 of this guide discusses other initial-year audit considerations).

Federal Agency and Pass-Through Entity Requests for Additional Major Programs

8.25 Section 215(c) of Circular A-133 permits a federal agency to request an auditee to have a particular federal program audited as a major program

in lieu of the federal agency conducting or arranging for additional audits. To allow for planning, such requests should be made at least 180 days before the end of the fiscal year to be audited. After consultation with its auditor, the auditee should promptly respond to such a request by informing the federal agency whether the program would otherwise be audited as a major program using the risk-based approach and, if not, the estimated incremental cost. The federal agency should then promptly confirm to the auditee whether it wants the program audited as a major program. If the program is to be audited as a major program based on the federal agency's request, and the federal agency agrees to pay the full incremental costs, then the auditee should have the program audited as a major program. This approach also may be used by pass-through entities for a subrecipient.

Low-Risk Auditee Criteria

8.26 Circular A-133 establishes certain conditions for determining whether an auditee is low risk. An auditee that meets all of the following conditions for each of the preceding two years (or in the case of biennial audits, the preceding two audit periods) qualifies as a low-risk auditee and is eligible for the reduced audit coverage discussed in paragraph 8.21:

- Single audits were performed on an annual basis in accordance with Circular A-133.³ An auditee that has biennial audits does not qualify as a low-risk auditee, unless agreed to in advance by the cognizant or oversight agency for audit.
- The auditor's opinions on the financial statements⁴ and the schedule of expenditures of federal awards were unqualified. However, the cognizant or oversight agency for audit may judge that an opinion qualification does not affect the management of federal awards and may provide a waiver.
- There were no deficiencies in internal control over financial reporting that were identified as material weaknesses under the requirements of *Government Auditing Standards*. However, the cognizant or oversight agency for audit may judge that any identified material weaknesses do not affect the management of federal awards and may provide a waiver.
- None of the federal programs had audit findings from any of the following in either of the preceding two years (or in the case of biennial audits, the preceding two audit periods) in which they were classified as type A programs:

³ The *Compliance Supplement* provides updated guidance applicable to all auditees regarding low-risk auditee status. Appendix 7, "Other OMB Circular A-133 Advisories," states that in order for an auditee to meet the criteria of a low-risk auditee in the current year, the prior 2 years' audits must have met the requirements of Circular A-133, including report submission to the Federal Audit Clearinghouse (FAC) by the due date. A report submission is considered late if the entity is not in compliance with the 9 month due date rule (or other revised due date in the case of a properly approved extension). Appendix 7 of the *Compliance Supplement* also includes steps the auditor may consider to identify FAC submissions that do not meet the due date. (See footnote * in paragraph 8.08.)

⁴ As explained in the AICPA Audit and Accounting Guide *State and Local Governments*, the auditor generally expresses or disclaims an opinion on a government's basic financial statements by providing an opinion or disclaimer of opinion on each opinion unit required to be presented in those financial statements. For purposes of determining low-risk auditee status for governmental entities, the auditor's opinion on each opinion unit should be unqualified.

- Material weaknesses in internal control over compliance
- Noncompliance with the provisions of laws, regulations, contracts, or grant agreements that have a material effect on the type A program
- Known or likely questioned costs that exceed five percent of the total federal awards expended for a type A program during the year

Criteria for Federal Program Risk

8.27 Circular A-133 includes certain conditions that, when met, indicate that a type A program may be low risk (see paragraphs 8.11–.12). As noted in paragraphs 8.13 and 8.15, in making the final determination of whether a type A program is low risk or a type B program is high risk, the auditor should use professional judgment and also consider the risk criteria discussed in paragraphs 8.28–.37. The auditor's risk assessment should be based on an overall evaluation of the risks of noncompliance occurring, which could be material to the federal program being evaluated. As a part of the risk assessment, the auditor may also wish to discuss a particular federal program with auditee management and with the federal agency or pass-through entity. The rest of this chapter discusses the criteria for federal program risk that are identified in Circular A-133 for the auditor's consideration.

Current and Prior Audit Experience

8.28 The auditor should consider his or her current and prior experience with the auditee and the results of audits performed in the past. The auditor should consider the following specific factors, as discussed in paragraphs 8.29–.34:

- Effectiveness of internal control over compliance for federal programs
- Federal programs administered under multiple internal control structures
- The system for monitoring subrecipients when significant parts of federal programs are passed through to subrecipients
- The extent to which computer processing is used
- Prior audit findings
- Federal programs not recently audited as major

Effectiveness of Internal Control Over Federal Programs

8.29 In assessing program risk, the auditor should consider internal control over compliance for federal programs. (See chapter 9, "Consideration of Internal Control Over Compliance for Major Programs," of this guide.) Weak internal control over compliance for federal programs is an indication of higher risk. Consideration also should be given to the control environment over federal programs and to such factors as the expectation of management's adherence to applicable laws and regulations and the provisions of contracts and grant agreements. The auditor may also consider the competence and experience of the personnel who administer federal programs. An indication of higher risk would exist in instances in which the staff are new or do not have experience with a program.

Federal Programs Administered Under Multiple Internal Control Structures

8.30 Federal programs administered by multiple internal control structures may have a higher risk. This often occurs when multiple organizational units (for example, locations or branches) are involved in the administration of federal programs. An example of this would be a university that has several campuses administering a federal program. When assessing risk, the auditor should consider whether any internal control weaknesses are isolated in a single operating unit (that is, one college campus) or are pervasive throughout the entity. If the identified weaknesses are isolated, and absent other weaknesses, the auditor could still potentially reach the conclusion that the program is low risk. The final determination would be based on the auditor's judgment.

System for Monitoring Subrecipients

8.31 Consideration should be given to the extent that federal programs are passed through to subrecipients. Circular A-133 states that when significant parts of a federal program are passed through to subrecipients, a weak system for monitoring subrecipients would indicate higher risk. Alternatively, if the auditee passes a significant portion of programs to subrecipients and the auditee has an effective system in place to monitor the subrecipients, this might be indicative of a lower level of risk to the program.

Extent to Which Computer Processing Is Used

8.32 When assessing risk, Circular A-133 states that the auditor should consider the extent to which computer processing is used to administer federal programs, as well as the complexity of that processing. A complex system does not always indicate higher risk. On the other hand, a newly installed system that has not been tested in the past, or a recently modified system, may indicate higher risk. AU section 326, *Audit Evidence*, and AU section 314, *Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement* (AICPA, *Professional Standards*, vol. 1), contain requirements and guidance when significant auditee information is transmitted, processed, maintained, or accessed electronically.

Prior Audit Findings

8.33 As a part of the risk assessment, Circular A-133 states that the auditor should consider prior audit findings. In addition, as discussed in chapter 2 of this guide, paragraph 4.09 of *Government Auditing Standards* establishes an additional fieldwork standard that states the auditor should evaluate whether the audited entity has taken appropriate corrective action to address findings and recommendations from previous engagements that could have a material effect on the financial statements. This information should be used in assessing risk and determining the nature, timing, and extent of current audit work. An indication of higher risk would exist for prior audit findings that could have a significant impact on a federal program or for which no corrective action has been implemented because the findings were identified. These findings may be the result, for example, of previous single audits by independent auditors or of compliance or financial audits performed by internal auditors or government auditors in conjunction with the federal awarding agency's monitoring activities.

Federal Programs Not Recently Audited as Major

8.34 Federal programs that have not recently been audited as major programs may be of higher risk than federal programs recently audited as major. For example, many type B programs may never have been audited as major programs in the past. A higher level of risk would likely be assessed on such programs than on those programs that have been consistently audited as major programs without audit findings.

Oversight Exercised by Federal Agencies and Pass-Through Entities

8.35 The oversight exercised by federal agencies or pass-through entities could indicate risk. An important factor in assessing risk is the results of recent audits performed by federal agencies or pass-through entities. For example, recent monitoring or other reviews that were performed by an oversight entity and that disclosed no audit findings may indicate lower risk, whereas monitoring that disclosed significant findings could indicate higher risk. However, reviews performed by federal agencies or pass-through entities vary widely with coverage and intensity. Therefore, consideration of the scope of reviews performed may assist the auditor in evaluating whether the reviews increase, decrease, or have no impact on risk.

8.36 Section 525(c)(2) of Circular A-133 states that federal agencies, with the concurrence of the OMB, may identify federal programs that are higher-risk. That identification is provided by the OMB in the *Compliance Supplement*. For example, the U.S. Department of Health and Human Services has identified the Medicaid Assistance Program as a program of higher risk in the *Compliance Supplement*. Although such an identification by a federal agency does not preclude an auditor from determining that a program is low risk (for example, because prior audits have shown strong internal control and compliance), the consideration of this identification of higher risk is part of the risk assessment process.

Inherent Risk of Noncompliance of the Federal Programs

8.37 As part of the risk assessment, the auditor should consider the inherent risk of noncompliance of federal programs. The nature of some programs may indicate higher inherent risk of noncompliance. Programs with higher inherent risk of noncompliance may be of a higher risk for the purpose of determining major programs. Circular A-133 provides the following examples of program characteristics with potentially higher inherent risk of noncompliance:

- Complex programs and the extent to which a program contracts for goods and services have the potential for higher risk. For example, federal programs that disburse funds through third-party contracts or have eligibility criteria may be of higher risk. Federal programs primarily involving staff payroll costs may have a high risk for time-and-effort reporting but may otherwise be at low risk.
- The phase of a federal program's life cycle at the federal agency may indicate risk. For example, a new program with new or interim regulations may have a higher risk than an established program with time-tested regulations. In addition, significant changes in federal programs, laws, or regulations or in the provisions of contracts or grant agreements may increase risk.

- The phase of a program's life cycle at the auditee may indicate risk. For example, during the first and last years in which an auditee participates in a program, the risk may be higher because of the start-up or closeout of the program's activities and staff.
- Type B programs with larger federal awards expended would be of higher risk than would programs with substantially smaller federal awards expended.

American Recovery and Reinvestment Act Considerations[†]

8.38 The expenditure of Recovery Act awards has a significant impact on the determination of major programs. When considering the effect of Recovery Act awards on major program determination, it is important to remember that the awards may be provided under a new or existing Catalog of Federal Domestic Assistance (CFDA) number.

8.39 Appendix 7 of the *Compliance Supplement*,^{*} includes requirements and guidance relating to the effect of the Recovery Act on major program determination, some of which relates to clusters. It notes that other clusters listed in Part 5 of the *Compliance Supplement*, to which a federal program with a new Recovery Act CFDA number has been added during the current year that also has current year expenditures, should be considered a new program and would not qualify as a low-risk type A program under Section .520 of Circular A-133. Appendix 7 also states that the guidance in this paragraph does not apply to a Research and Development (R&D) or Student Financial Aid (SFA) cluster.

8.40 For other type A programs with Recovery Act expenditures (including R&D), Appendix 7 states that even though a type A program otherwise meets the criteria as low risk under Section .520(c) of Circular A-133, due to the inherent risk associated with the transparency and accountability requirements governing expenditures of Recovery Act awards, any program or cluster with expenditures of Recovery Act awards (other than SFA) would not qualify as a low-risk type A. However, Appendix 7 goes on to provide an exception to this rule. It states that auditors may consider a type A program or cluster to be low risk if all of the following conditions are met:

- The program or cluster had Recovery Act expenditures in the prior audit period.
- The program or cluster was audited as a major program in the prior audit period.
- The Recovery Act expenditures in the current audit period are less than 20 percent of the total program or cluster expenditures.

[†] Information in this guide related to the American Recovery and Reinvestment Act of 2009 (Recovery Act) is based upon the latest information available at the time of this writing. However, this information is subject to change because guidance from the OMB is being issued and updated on an ongoing basis. It is important that recipients of Recovery Act funding, and their auditors, monitor the guidance issued. For the latest OMB guidance, go to the OMB website at www.whitehouse.gov/omb/recovery_default. Information can also be found at the Recovery Act Resource Center on the Governmental Audit Quality Center website, which is open to the public at www.aicpa.org/INTERESTAREAS/GOVERNMENTALAUDITQUALITY/RESOURCES/RECOVERYACTRESOURCECENTER/Pages/default.aspx and at the U.S. Government's official Recovery Act website at www.recovery.gov.

^{*} See footnote * in paragraph 8.08.

- The auditor has followed Sections .520(c) and .525 of Circular A-133 and determined that the program or cluster is otherwise low risk.

8.41 With regard to type B programs, Appendix 7 states that the auditor should consider all type B programs and clusters with expenditures of Recovery Act awards to be programs of higher risk in accordance with Section .525(d) of Circular A-133. The presumption is that type B programs or clusters with Recovery Act expenditures would be audited as major when applying the provisions of Section .520(e)(2). However, the auditor, when applying Section .520(e)(2), is not precluded from selecting an especially risky type B program that does not contain Recovery Act expenditures to audit as a major program in lieu of a type B program or cluster with Recovery Act expenditures. (Note that his paragraph does not apply to SFA clusters).

8.42 Auditors are advised to review Appendix 7 of the *Compliance Supplement*^{*} to fully understand the major program determination requirements and guidance issued by the OMB for 2010 and to periodically check the OMB website at www.whitehouse.gov/omb/grants_circulars/ for any future addendum that might be issued.

8.43 For auditors who may still be performing 2009 single audits, see the 2009 *Compliance Supplement* and related 2009 addendum for the requirements and guidance in effect for 2009 single audits. Additionally, the AICPA Governmental Audit Quality Center issued an alert (GAQC Alert #123) that also provides additional guidance from the OMB on 2009 major program determination considerations and can be accessed at www.aicpa.org/INTERESTAREAS/GOVERNMENTALAUDITQUALITY/RESOURCES/RECOVERYACTRESOURCECENTER/Pages/default.aspx.

^{*} See footnote ^{*} in paragraph 8.08.

Chapter 9

Consideration of Internal Control Over Compliance for Major Programs

Note: The audit required by the Single Audit Act Amendments of 1996 and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, should be performed in accordance with *Government Auditing Standards*. Part I, "Government Auditing Standards Audits," (chapters 2–4 of this guide) discusses financial statement audits under generally accepted auditing standards and *Government Auditing Standards*. The guidance in parts I and II, "Circular A-133 Audits," (chapters 5–14 of this guide) is applicable for those auditors performing an audit under the Single Audit Act Amendments of 1996 and Circular A-133.

Information related to the American Recovery and Reinvestment Act of 2009 (Recovery Act) can be found in a section located at the end of each chapter in part II of this guide. See the section titled "American Recovery and Reinvestment Act Considerations" beginning at paragraph 9.58 in this chapter. See also the preface section titled "Impact of the American Recovery and Reinvestment Act of 2009 on Single Audits."

9.01 Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133), establishes requirements for additional audit procedures and reporting relative to the auditor's consideration of internal control over compliance for major programs. Those requirements are beyond those of a financial statement audit conducted in accordance with generally accepted auditing standards (GAAS) and *Government Auditing Standards*. Chapter 3, "Financial Statement Audit Considerations of *Government Auditing Standards*," of this guide discusses the auditor's consideration of internal control over financial reporting in a financial statement audit. (As discussed in chapter 6, "Planning Considerations of Circular A-133," of this guide, Circular A-133 does not impose on the financial statement audit any additional audit requirements beyond *Government Auditing Standards*.) This chapter discusses the additional considerations of internal control over compliance for major programs. Paragraph 9.03 and chapter 13, "Auditor Reporting Requirements and Other Communication Considerations in a Single Audit," of this guide discuss the reporting on internal control over compliance for major programs.

Summary of Circular A-133 Requirements Related to Internal Control Over Compliance for Federal Programs

Auditee Responsibilities

9.02 Circular A-133 states that the auditee should maintain internal control over compliance for federal programs that provides reasonable assurance

that the auditee is managing federal awards in compliance with laws, regulations, and provisions of contracts or grant agreements that could have a material effect on each of its federal programs (*compliance requirements*).

Auditor Responsibilities

9.03 In addition to the requirements of GAAS and *Government Auditing Standards*, Circular A-133, as revised on June 26, 2007, states that the auditor should

- perform procedures to obtain an understanding of internal control over compliance for federal programs that is sufficient to plan the audit to support a low assessed level of control risk for major programs.¹
- plan the testing of internal control over compliance for major programs to support a low assessed level of control risk for the assertions relevant to the compliance requirements for each major program.²
- perform testing of internal control over compliance as planned.
- report on internal control over compliance describing the scope of the testing of internal control and the results of the tests and, where applicable, referring to the separate schedule of findings and questioned costs. This schedule includes, where applicable, a statement that significant deficiencies in internal control over compliance for major programs were identified in the audit and whether any such deficiencies were material weaknesses.

Auditor Responsibility for Internal Control Over Compliance for Programs That Are Not Major

9.04 The auditor has no responsibility under Circular A-133 to obtain an understanding of internal control over compliance for programs that are not considered major, or to plan or perform any related testing of internal control over compliance for those programs except for any procedures the auditor may choose to perform as part of the risk assessment process in determining major programs. (Chapter 8, "Determination of Major Programs," of this guide discusses the risk assessment process.) However, a program that is not considered major could still be material to the financial statements.³ In that situation, in conjunction with the financial statement audit, the auditor may need to obtain an understanding of that program's internal control over financial reporting.

¹ In part II of this guide, the term *control risk of noncompliance* is used in order to be consistent with the term as used and defined in Statement on Auditing Standards (SAS) No. 117, *Compliance Audits* (AICPA, *Professional Standards*, vol. 1, AU sec. 801). The term *control risk* is used only when directly citing Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133). Both terms have the same meaning.

² See paragraphs 9.22–25 for a discussion of planning the testing of internal control over compliance to support a low assessed level of control risk of noncompliance. See paragraphs 9.26–28 for situations where the internal control over some or all of the compliance requirements for a major program is likely to be ineffective.

³ As discussed in the AICPA Audit and Accounting Guide *State and Local Governments*, the auditor's consideration of materiality for purposes of planning, performing, evaluating the results of, and reporting on the audit of the financial statements of a state or local government is based on opinion units. See that guide for further guidance.

Circular A-133 Definition of Internal Control Over Federal Programs

9.05 Circular A-133 defines *internal control over federal programs* as follows:

Internal control pertaining to the compliance requirements for federal programs (*internal control over federal programs*) means a process—effected by an entity's management and other personnel—designed to provide reasonable assurance regarding the achievement of the following objectives for federal programs:

1. Transactions are properly recorded and accounted for to:
 - a. Permit the preparation of reliable financial statements and federal reports;
 - b. Maintain accountability over assets; and
 - c. Demonstrate compliance with laws, regulations, and other compliance requirements;
2. Transactions are executed in compliance with:
 - a. Laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on a federal program; and
 - b. Any other laws and regulations that are identified in the compliance supplement; and
3. Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition.

Control Objectives and the Elements of Internal Control

9.06 AU section 314, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AICPA, *Professional Standards*, vol. 1), states that there are three objectives of internal control: reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. There is a direct relationship between an entity's objectives and the internal control components it implements to provide reasonable assurance about their achievement. For purposes of this guide, controls relevant to the audit of the financial statements are referred to as "internal control over financial reporting" and are encompassed in the report on internal control over financial reporting that is required by *Government Auditing Standards*. (See chapters 3–4 of this guide.) Controls relevant to an audit of compliance with requirements applicable to major federal programs are referred to collectively in this guide as "internal control over compliance" and are encompassed in the report on internal control over compliance required by Circular A-133. In a particular single audit engagement, some controls may be relevant to both the audit of the financial statements and the audit of compliance. When this occurs, those controls would be encompassed in both internal control reports. Chapter 13 of this guide provides guidance on reporting findings involving significant deficiencies and material weaknesses in internal control in such a circumstance.

9.07 AU section 314 states that internal control consists of five interrelated components:

Control environment. Sets the tone of the entity, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure.

Risk assessment. The entity's identification and analysis of relevant risks to the achievement of its objectives, forming a basis for determining how the risks should be managed.

Information and communication systems. Support the identification, capture, and exchange of information in a form and time-frame that enable people to carry out their responsibilities.

Control activities. The policies and procedures that help ensure that management directives are carried out.

Monitoring. A process that assesses the quality of internal control performance over time.

These components assist the auditor in considering how the different aspects of an entity's internal control may affect the audit. When considering internal control over compliance for major programs the auditor's focus is on the internal control objective related to compliance with laws, regulations, and the provisions of contracts or grant agreements.

Auditor's Consideration of Internal Control Over Compliance for Each Major Program

9.08 The auditor's consideration of internal control over compliance for each major program is similar to the consideration of internal control over financial reporting in a financial statement audit as described in AU section 314. The same concepts apply for understanding internal control over compliance, assessing risk, and the testing of controls. However, as noted in paragraph 9.03, Circular A-133 adds requirements to plan the audit to support a low assessed level of control risk of noncompliance, to perform related procedures and testing, and to report on internal control over compliance. Also, instead of the objective being reliability of financial reporting, it is compliance with laws, regulations, and the provisions of contracts or grant agreements.

9.09 When considering internal control over compliance, the auditor should obtain an understanding of the five elements of internal control sufficient to assess the risks of material noncompliance with each direct and material compliance requirement for each major program. The auditor should obtain a sufficient understanding by performing risk assessment procedures to evaluate the design of controls relevant to the compliance audit and to determine whether they have been implemented. The auditor should use the information gathered by performing the risk assessment procedures, including the audit evidence obtained in evaluating the design of controls and determining whether they have been implemented, as audit evidence to support the risk assessment. The risk assessment should be used to determine the nature, timing and extent of further audit procedures to be performed. When the risk assessment is based on an expectation that controls are operating effectively, the auditor should perform tests of controls to support a low assessed level of control risk of noncompliance.

9.10 Procedures for gaining an understanding of internal control over compliance and an assessment of the risks of noncompliance may be performed concurrently in an audit. Similarly, based on the assessed level of control risk of noncompliance that the auditor expects to support and on audit efficiency considerations, the auditor may perform some tests of controls concurrently with obtaining an understanding of controls. See the discussion beginning at paragraph 9.29 for information on the testing of controls.

Obtaining an Understanding of Internal Control Over Direct and Material Compliance Requirements for Major Programs

Understanding Direct and Material Compliance Requirements and Identifying Relevant Controls

9.11 As noted in paragraph 9.03, the auditor should perform procedures to obtain an understanding of internal control over compliance for federal programs that is sufficient to plan the audit to support a low assessed level of control risk of noncompliance for major programs. (Chapter 8 of this guide discusses the determination of major programs.) In order to do this, an understanding is needed of which of the 14 types of compliance requirements identified in the *OMB Circular A-133 Compliance Supplement (Compliance Supplement)* have a direct and material effect on each major program. (See also chapter 10, "Compliance Auditing Applicable to Major Programs," for a discussion of identifying direct and material compliance requirements.) Once the auditor has identified those compliance requirements that have a direct and material effect on each major program, the understanding of those direct and material compliance requirements will determine the types of controls the auditor needs to consider in a Circular A-133 compliance audit.

9.12 In order to identify the controls relevant to the direct and material compliance requirements, the auditor should obtain an understanding of the five components of internal control in relation to the direct and material compliance requirements for each major program. In obtaining an understanding of internal control, paragraphs .54–.56 of AU section 314 provide requirements and guidance. Obtaining an understanding of internal control involves evaluating the design of a control and determining whether it has been implemented. Evaluating the design of a control involves consideration of whether the control, individually or in combination with other controls, is capable of effectively preventing or detecting and correcting instances of noncompliance. Implementation of a control means that the control exists and that the entity is using it. The auditor should consider the design of the control in determining whether to consider its implementation. (See paragraph 9.26 for a discussion of ineffective internal control.)

9.13 The auditor should perform risk assessment procedures as found in paragraph .06 of AU section 314. The objective of these procedures is to obtain audit evidence about the design and implementation of relevant controls and may include inquiry of entity personnel, observing the application of a specific control, and inspecting documents and reports. Paragraph .55 of AU section 314 states that inquiry alone is not sufficient to evaluate the design of a control and to determine whether it has been implemented. (See chapter 6 for a discussion of risk assessment.)

9.14 The auditor should obtain an understanding of how IT affects control activities that are relevant to planning the audit. The use of IT affects the fundamental manner in which transactions are initiated, authorized, recorded, processed, and reported. When IT is used for these purposes, the systems and programs may include controls related to direct and material compliance requirements or may be critical to the effective functioning of manual controls that depend on IT. An entity's mix of manual and automated controls varies with the nature and complexity of the entity's use of IT. (See paragraphs .57–.63 of AU section 314 for more guidance on the effect IT has on the auditor's risk assessment process.)

9.15 Obtaining an understanding of an entity's controls is generally not sufficient to serve as testing the operating effectiveness of controls (as discussed in paragraphs 9.20–.39). Further, simply testing compliance in accordance with Circular A-133 does not provide evidence that controls are operating effectively. Testing compliance gives indirect evidence on the effectiveness of controls, but cannot serve as the basis for assessing controls as operating effectively. Generally, testing controls assists the auditor in determining the nature, timing, and extent of substantive audit procedures to perform in order to gather evidence related to the opinion on compliance.

9.16 Entities may use the same controls for more than one federal program and for similar transactions (for example, cash disbursements). Accordingly, those controls will often provide assurance regarding the achievement of the compliance objectives related to some or all federal program transactions and assets. However, the use of the same controls does not negate the need to gain an understanding for each major program.

Compliance Supplement Internal Control Guidance

9.17 Part 6 of the *Compliance Supplement* provides the auditor with guidance and a general discussion of the control objectives, components, and activities that are likely to apply to the 14 types of compliance requirements. (Chapter 10 of this guide discusses the *Compliance Supplement* and the types of compliance requirements.) In addition, for 13 of the 14 types of compliance requirements, objectives of internal control and examples of characteristics specific to the compliance requirements follow the general information. (The compliance requirement, "Special Tests and Provisions," is excluded because that requirement is unique to each program). The guidance in the *Compliance Supplement* is not a checklist of required internal control characteristics; it is intended, instead, to assist the auditor in planning and performing the Circular A-133 compliance audit. However, the auditee is responsible for designing and implementing internal control that is sufficient to provide reasonable assurance that the auditee is managing federal awards in compliance with laws, regulations, and provisions of contracts or grant agreements that could have a material effect on each of its federal programs. The auditee may need to design and implement control activities beyond those discussed in the *Compliance Supplement* to meet that responsibility. Similarly, the auditor is responsible for evaluating internal control over compliance and for planning the audit to support a low assessed level of control risk of noncompliance for each major program. The auditor may need to perform tests of internal control over compliance that are related to control objectives and activities in addition to those discussed in the *Compliance Supplement*.

Multiple-Component Considerations

9.18 Federal programs often are administered by multiple organizational units (for example, locations or branches) within an auditee. Each component may maintain separate internal control over compliance that is relevant to the programs, or parts of the programs, that the component administers. In these situations, the auditor should perform procedures to obtain an understanding of internal control over compliance that is separately maintained by organizational units and that is relevant to each material part of a major program, and should plan and perform testing of those controls as discussed in this guide. (Chapters 8 and 10–11 of this guide discuss other multiple-component considerations.)

Subrecipient Considerations

9.19 Many entities that are pass-through entities for federal awards make subcontract or subgrant awards and disburse their own funds, as well as federal funds, to subrecipients. The auditor of the pass-through entity has certain responsibilities related to the entity's internal control over the monitoring of subrecipients. If significant pass-through funds are awarded, subrecipient considerations could have a major impact on the risk assessment and internal control procedures performed. Chapter 12, "Audit Considerations of Federal Pass-Through Awards," of this guide discusses the audit considerations of federal pass-through awards.

Planning and Performing the Test of Operating Effectiveness of Internal Control Over Direct and Material Compliance Requirements for Each Major Program⁴

Assessing Control Risk of Noncompliance

9.20 *Control risk of noncompliance* is the risk that noncompliance with a compliance requirement that could occur and that could be material, either individually or when aggregated with other instances of noncompliance, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control over compliance. After obtaining an understanding of internal control over compliance for major programs, the auditor makes a preliminary assessment of control risk of noncompliance related to the direct and material compliance requirements for major programs. This information is used to determine whether the auditor can support a low assessed level of control risk of noncompliance. When the auditor believes, based on the understanding of internal control, that controls are capable of effectively preventing or detecting and correcting material noncompliance, the auditor may initially assess control risk of noncompliance at less than the maximum during the risk assessment phase of the audit. (See also chapter 6 of this guide, which discusses audit risk of noncompliance considerations in a Circular A-133 compliance audit, including control risk of noncompliance.)

9.21 The assessment of control risk of noncompliance is the process of evaluating preliminarily the effectiveness of an entity's internal control over

⁴ See also chapter 11, "Audit Sampling Considerations of Circular A-133 Compliance Audits," for more information related to understanding, planning, and performing tests related to internal control over compliance.

compliance in preventing or detecting material noncompliance with the compliance requirements for each major program. Paragraphs 9.22–.25 discuss the Circular A-133 requirement to plan the testing of internal control over compliance to support a low assessed level of control risk of noncompliance. Paragraphs 9.26–.28 discuss the auditor's responsibilities when internal control over compliance is ineffective in preventing or detecting noncompliance. The auditor's basis for judgment of the assessed level of control risk of noncompliance should be documented to support the decisions made. See paragraph 9.53 for a further discussion of audit documentation as it relates to internal control over compliance. The auditor should consider the results of his or her assessment of control risk of noncompliance, and any additional controls or tests of operating effectiveness in designing the nature, extent, and timing of substantive tests of compliance.

Planning the Test of Operating Effectiveness of Internal Control Over Compliance for Each Major Program to Support a Low Assessed Level of Control Risk of Noncompliance

9.22 Circular A-133 states that the auditor should plan the test of internal control over compliance for major programs to support a low assessed level of control risk for the assertions relevant to the compliance requirements for each major program. Professional standards do not define or quantify a low assessed level of control risk of noncompliance. Therefore, professional judgment is needed in determining the extent of control testing necessary to obtain a low level of control risk of noncompliance. In exercising professional judgment, one area to consider is the purpose of the requirement to plan the tests of controls to achieve a low assessed level of control risk of noncompliance (that is, federal agencies want to know if conditions indicate that auditees have not implemented adequate internal control over compliance for federal programs to ensure compliance with applicable laws and regulations).

9.23 The auditor should obtain sufficient appropriate audit evidence to support that assessed level of control risk of noncompliance. The type of audit evidence, its source, its timeliness, and the existence of other audit evidence related to the conclusions to which it leads all bear on the degree of assurance the audit evidence provides.

9.24 The guidance in AU section 318, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* (AICPA, *Professional Standards*, vol. 1), provides requirements and guidance regarding the testing of internal control. Paragraph .36 of AU section 318 states that the auditor should test controls for the particular time, or throughout the period, for which the auditor intends to rely on those controls. If the auditor needs audit evidence of the effectiveness of a control over a period, audit evidence pertaining only to a point in time may be insufficient, and the auditor should supplement those tests with other tests of controls that are capable of providing audit evidence that the control operated effectively at relevant times during the period under audit. This guidance, along with the Circular A-133 requirement to perform the testing of internal control to support a low assessed level of control risk of noncompliance, supports the testing of internal control over compliance every year. (See paragraph 9.31 for related information.)

9.25 Paragraphs .46–.49 of AU section 318 also contain guidance related to the extent of tests of controls. Because this guidance relates to a Circular A-133 compliance audit, and assuming an understanding that controls are

effective, the auditor should design sufficient tests of controls to obtain sufficient appropriate audit evidence that the controls are operating effectively for each direct and material compliance requirement for each major program throughout the period of reliance. Several factors are listed that auditors may consider in determining the extent of the tests of controls:

- The frequency of the performance of the control by the entity during the period
- The length of time during the audit period that the auditor is relying on the operating effectiveness of the control
- The relevance and reliability of the audit evidence to be obtained in supporting that the control prevents, or detects and corrects, material noncompliance with respect to the type of compliance requirement being considered
- The extent to which audit evidence is obtained from tests of other controls related to the type of compliance requirement
- The extent to which the auditor plans to rely on the operating effectiveness of the control in the assessment of risk (and thereby reduce substantive procedures based on the reliance of such control)
- The expected deviation from the control

Paragraph .48 of AU section 318 states that the auditor should increase the extent of tests of controls the more the auditor relies on the operating effectiveness of controls in the assessment of risk. In addition, as the rate of expected deviation from a control increases, the auditor should increase the extent of testing of the control. However, the auditor should consider whether the rate of expected deviation indicates that obtaining audit evidence from the performance of tests of controls will not be sufficient to reduce control risk of noncompliance for the assertions relevant to the compliance requirement. If the rate of expected deviation is expected to be too high, the auditor may determine that tests of controls for a particular type of compliance requirement may be inappropriate. See chapter 11, "Audit Sampling Considerations of Circular A-133 Compliance Audits," of this guide for more information on audit sampling as it relates to compliance audits.

Existence of Ineffective Internal Control in Preventing or Detecting Noncompliance

9.26 While gaining an understanding of internal control over compliance, if the auditor determines that internal control over compliance for some or all of the types of compliance requirements for a major program have not been implemented or are likely to be ineffective in preventing or detecting noncompliance, the auditor is not required to plan and perform tests of internal control over compliance to support a low assessed level of control risk of noncompliance for the relevant assertions. (See also paragraphs 9.03, 9.22, and 9.30. If internal control over compliance is deemed likely to be ineffective, Circular A-133 states that the auditor should assess control risk at the maximum⁵ and consider whether any additional compliance tests are required because of ineffective internal control. The auditor also should report a significant deficiency

⁵ It is not acceptable to simply deem risk to be "at the maximum." This assessment may be made in qualitative terms such as "high," "medium," and "low," or in quantitative terms such as percentages.

or a material weakness in internal control over compliance as part of the audit findings. (Chapter 13 of this guide discusses the reporting of significant deficiencies and material weaknesses in internal control over compliance.)

9.27 The assessment of the effectiveness of internal control over compliance in preventing, detecting, and correcting noncompliance is determined in relation to each individual type of compliance requirement or to an audit objective identified in the *Compliance Supplement* for each major program. For example, controls over requirements for eligibility may be ineffective because of a lack of segregation of duties. In this case, the auditor would do the following:

- Report the lack of segregation of incompatible duties as it relates to eligibility as a significant deficiency or a material weakness in internal control over compliance
- Assess the control risk of noncompliance related to requirements for eligibility at the maximum
- Consider the lack of effective control when designing the nature, timing, and extent of procedures designed to test compliance with requirements for eligibility of the major program. In most cases, the extent of testing would need to be expanded

9.28 In planning the tests of controls, consideration of the results of tests performed in prior years provides the auditor with important information. If the results of the prior year tests of controls prevented the auditor from assessing a low level of control risk of noncompliance, the auditor may consider expanded testing in the current audit period. Testing of any changes in internal control over compliance that were intended to eliminate deficiencies noted in the previous year also may provide relevant information. If, however, the auditor concluded in the prior year that internal control over compliance for one or more compliance requirements was ineffective and the auditee has made no changes to its internal control over compliance, the auditor may determine that controls are not likely to be effective and may choose not to plan and perform tests of controls. In this situation, the auditor should report a significant deficiency or a material weakness in internal control over compliance as discussed in paragraph 9.26.

Performing Tests to Evaluate the Effectiveness of Controls

9.29 As discussed in paragraph .26 of AU section 318, testing the operating effectiveness of controls is different from obtaining audit evidence that controls have been implemented. When obtaining audit evidence of implementation by performing risk assessment procedures, the auditor should determine that the relevant controls exist and that the entity is using them. When performing tests of controls, the auditor should obtain audit evidence that controls operate effectively. This includes obtaining audit evidence about how controls were applied at relevant times during the period under audit, the consistency with which they were applied, and by whom or by what means they were applied.

9.30 As noted in paragraph 9.03, Circular A-133 states that the auditors should perform tests of internal control over compliance as planned. (Paragraphs 9.26–.28 discuss an exception related to ineffective internal control over compliance. In addition, paragraph .24 of AU section 318 states that the auditor should perform tests of controls when the auditor's risk assessment includes an expectation of the operating effectiveness of control. Testing of the operating effectiveness of controls ordinarily includes procedures such as (a) inquiries of

appropriate entity personnel, including grant and contract managers; (b) the inspection of documents, reports, or electronic files indicating performance of the control; (c) the observation of the application of the specific controls; and (d) reperformance of the application of the control by the auditor. The auditor should perform such procedures regardless of whether he or she would otherwise choose to obtain evidence to support an assessment of control risk of noncompliance below the maximum level.

9.31 Furthermore, Statement on Auditing Standards (SAS) No. 117, *Compliance Audits* (AICPA, *Professional Standards*, vol. 1, AU sec. 801), indicates that paragraphs .40–.45 of AU section 318 are not applicable to a compliance audit. Those paragraphs address the use of audit evidence obtained in prior audits related to testing the operating effectiveness of controls (and the rotation of such testing). Therefore, in a Circular A-133 compliance audit, controls that address the risks of noncompliance with direct and material types of compliance requirements for major programs should be tested every year.

9.32 Paragraph .33 of AU section 318 provides guidance related to the testing of controls. When responding to the risk assessment, the auditor may design a test of controls to be performed concurrently with a test of details on the same transactions. Although the objectives of the tests are different, both may be accomplished concurrently through performance of a test of controls and a test of details on the same transaction (a dual-purpose test). For example, the auditor may examine an invoice to determine whether it has been approved and to provide substantive evidence of a transaction. The auditor should carefully consider the design and evaluation of such tests in order to accomplish both objectives.⁶ Also, when performing the tests, the auditor should consider how the outcome of the test of controls may affect the auditor's determination about the extent of substantive procedures to be performed. See chapter 11 of this guide for a discussion of the use of dual purpose samples in a compliance audit.

Evaluating the Results of Tests of Controls⁷

9.33 Based on the audit procedures performed related to controls, and the audit evidence obtained, the auditor should evaluate whether the assessment of the risk of material noncompliance of the relevant compliance requirements remain appropriate. An audit is a cumulative and iterative process. As the auditor performs planned audit procedures, the audit evidence obtained may cause the auditor to modify the nature, timing, or extent of other planned audit procedures. Information may come to the auditor's attention that differs significantly from the information on which the risk assessments were based. The auditor should determine whether the tests of controls performed provide an appropriate basis for reliance on the controls, whether additional tests of controls are necessary or whether the potential risks of noncompliance need to be addressed using substantive procedures. Furthermore, the auditor should not assume that an instance of fraud or error is an isolated occurrence, and therefore should consider how the detection of such noncompliance affects the

⁶ Quality control reviews of Circular A-133 compliance audits have shown that in some cases auditors, when using dual purpose testing, have not clearly identified the procedures performed to test compliance versus internal control over compliance. It is important that the audit documentation relating to dual purpose tests separately identify the results of dual purpose testing (that is, both the results of the tests of controls and the tests of details) through such mechanisms as narratives, tickmarks, or similar notations.

⁷ The discussion of audit sampling in a compliance audit, as found in chapter 11, will assist the auditor in evaluating the results of audit testing.

assessed risks of material noncompliance. Before the conclusion of the audit, the auditor should evaluate whether audit risk of noncompliance has been reduced to an appropriately low level and whether the nature, timing and extent of the audit procedures need to be reconsidered. The auditor should conclude whether sufficient appropriate audit evidence has been obtained to reduce to an appropriately low level the risks of material noncompliance with compliance requirements. In developing an opinion on compliance, the auditor should consider all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the relevant assertions.

9.34 If, when evaluating the results of tests of controls, the auditor is not able to support a low assessed level of control risk of noncompliance for a direct and material compliance requirement for a major program, the auditor is not required to expand his or her testing of internal control over compliance for that compliance requirement. The auditor may choose not to perform further tests of controls. In that situation, the auditor would assess control risk of noncompliance at other than low, design tests of compliance accordingly, and consider the need to report an audit finding. In general, a significant deficiency or a material weakness in internal control over compliance will need to be reported. (See chapter 13 of this guide for further discussion on reporting audit findings.)

9.35 The concept of effectiveness of the operation of controls recognizes that some deviations in the way controls are applied by the entity may occur. When such deviations are detected during the performance of tests of controls, the auditor should make specific inquiries to understand these matters and their potential consequences. In addition, the auditor should consider whether any noncompliance detected from the performance of substantive procedures alter the auditor's judgment as to the effectiveness of the related controls. The auditor should determine whether the tests of controls performed provide an appropriate basis for reliance on the controls, whether additional tests of controls are necessary, or whether the potential risks of noncompliance need to be addressed using substantive procedures.

9.36 On the other hand, the auditor may decide to expand the testing of internal control over compliance, but that decision would be based on whether the auditor considered expanded internal control testing to be more efficient than additional tests of compliance. Based on the testing performed, control risk of noncompliance might be assessed below the maximum and therefore reduce substantive tests of compliance. If it cannot be assessed below the maximum, it might be more appropriate to assess control risk of noncompliance at the maximum level. (See also paragraph 9.26.)

9.37 Regardless of the audit approach selected, the auditor should design and perform substantive procedures for all relevant assertions related to the compliance requirements for major programs. Because effective controls generally reduce, but do not eliminate, risks of material noncompliance, tests of controls reduce, but do not eliminate the need for substantive procedures.

9.38 When evaluating the operating effectiveness of internal control over compliance, instances of noncompliance detected by the auditor when performing compliance tests should be considered by the auditor. (For example, during a test of compliance for activities allowed or unallowed, it was noted that equipment was charged to a major program when the grant agreement does not allow program funds to be spent on equipment.) Detection of these instances of

noncompliance is relevant, reliable audit evidence about the relative ineffectiveness of the related internal control over compliance. Noncompliance detected by the auditor that was not identified by the entity is evidence of a deficiency in internal control over compliance and may be an indicator of a significant deficiency or a material weakness in internal control over compliance.

9.39 In addition, the absence of noncompliance detected by a compliance test does not provide audit evidence that controls related to a compliance requirement are effective.

Significant Deficiencies and Material Weaknesses in Internal Control Over Compliance Related to Federal Programs

9.40 A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct noncompliance with a type of compliance requirement of a federal program on a timely basis. See paragraph 9.51 for examples of circumstances that may be deficiencies, significant deficiencies, or material weaknesses in internal control over compliance.

9.41 For purposes of reporting on internal control over compliance for federal programs, SAS No. 117 defines *significant deficiency in internal control over compliance* and *material weakness in internal control over compliance* as follows:

- A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.
- A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance such that there is a reasonable possibility that material noncompliance with a compliance requirement will not be prevented or detected and corrected on a timely basis.⁸

9.42 In performing a Circular A-133 compliance audit, significant deficiencies and material weaknesses related to internal control over compliance and material noncompliance with provisions of laws, regulations, contract or grant agreements are to be considered as they relate to a type of compliance requirement for each major program or to an audit objective identified in the *Compliance Supplement*. Further, certain conditions may be significant deficiencies for a major program and not be considered significant deficiencies as they relate to the assertions of management in the financial statements.

9.43 The auditor should evaluate the severity of each deficiency in internal control over compliance identified during the audit to determine whether

⁸ A reasonable possibility exists when the likelihood of the event is either *reasonably possible* or *probable*, which are defined as follows:

Reasonably possible. The chance of the future event or events occurring is more than remote but less than likely.

Remote. The chance of the future event or events occurring is slight.

Probable. The future event or events are likely to occur.

the deficiency, individually or in combination, is a significant deficiency or material weakness in internal control over compliance. The severity of a deficiency depends on the magnitude of potential noncompliance resulting from the deficiency or deficiencies and whether there is a reasonable possibility that the entity's controls will fail to prevent or detect and correct noncompliance with a type of compliance requirement. In a Circular A-133 compliance audit, the significance of a deficiency in internal control over compliance depends on the potential for noncompliance, not on whether noncompliance actually has occurred. Accordingly, the absence of identified noncompliance does not provide evidence that identified deficiencies in internal control over compliance are not significant deficiencies or material weaknesses in internal control over compliance.

9.44 Risk factors affect whether there is a reasonable possibility that a deficiency, or combination of deficiencies, will result in noncompliance with a type of compliance requirement of a federal program. The factors include, but are not limited to,

- the nature of the type of compliance requirement involved. For example, a specific special test or provision may involve greater risk because it is unique to the program and may require unique controls.
- susceptibility of the program and related types of compliance requirements to fraud.
- subjectivity and complexity involved in meeting the compliance requirement, and the extent of judgment required in determining noncompliance.
- interaction or relationship of the control with other controls.
- interaction among the deficiencies.
- possible future consequences of the deficiency.

9.45 The evaluation of deficiencies in internal control over compliance includes the magnitude of potential noncompliance. Several factors affect the magnitude of potential noncompliance that could result from a deficiency or deficiencies in controls. The factors may include, but are not limited to, the following:

- Program amounts or total of transactions exposed to the deficiency, in relation to the type of compliance requirement;
- Volume of activity related to the compliance requirement exposed to the deficiency in the current period or expected in future periods; or
- Adverse publicity or other qualitative factors.

9.46 Multiple deficiencies that affect the same type of compliance requirement or component of internal control over compliance increase the likelihood of material noncompliance and may, in combination, constitute a significant deficiency or material weakness in internal control over compliance, even though such deficiencies individually may be less severe. Therefore, the auditor should determine whether deficiencies that affect the same type of compliance requirement or component of internal control collectively result in a significant deficiency or material weakness in internal control over compliance.

9.47 The auditor may obtain evidence that a control does not operate effectively when performing compliance tests or tests of the operating effectiveness of controls, for example identifying an instance of noncompliance that was not prevented, or detected and corrected by the control. Management may inform the auditor, or the auditor may otherwise become aware, of the existence of compensating controls that, if effective, may limit the severity of the deficiency and prevent it from being a significant deficiency or material weakness in internal control over compliance. In these circumstances, although the auditor is not required to consider the effects of compensating controls, the auditor may consider the effects of compensating controls related to a deficiency in operation provided the auditor has tested the compensating controls for operating effectiveness. Compensating controls can limit the severity of the deficiency, but do not eliminate the deficiency.

9.48 The auditor may encounter deviations in the operating effectiveness of controls. A control that has an observed non-negligible deviation rate is at least a deficiency in internal control over compliance regardless of the reason for the deviation and could be, based upon further evaluation, a significant deficiency or material weakness in internal control over compliance. For example, if the auditor designs a test in which he or she selects a sample and expects no deviations, the finding of one deviation is a nonnegligible deviation rate because, based on the results of the auditor's test of the sample, the desired level of confidence was not obtained. See chapter 11 of this guide for more information on evaluating deviations in tests of controls.

9.49 If the auditor determines that a deficiency, or a combination of deficiencies, is not a material weakness in internal control over compliance, the auditor should consider whether prudent officials, having knowledge of the same facts and circumstances, would likely reach the same conclusion.

9.50 Indicators of material weaknesses in internal control over compliance include

- identification of fraud in the major program of any magnitude on the part of senior program management. For the purposes of evaluating and communicating deficiencies in internal control over compliance, the auditor should evaluate fraud of any magnitude of which he or she is aware on the part of senior program management, including fraud resulting in immaterial noncompliance.
- identification by the auditor of material noncompliance for the period under audit in circumstances that indicate that the noncompliance would not have been detected by the entity's internal control (for example, the noncompliance was not initially identified by the entity's internal control).
- ineffective oversight by management, or those charged with governance, over compliance with program requirements where the activity is subject to a type of compliance requirement (for example, lack of adequate review of federal financial reports prior to submission to the grantor).

9.51 Exhibit B of AU section 325, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1), contains examples of circumstances that may be deficiencies, significant deficiencies, or material weaknesses. Examples included relate to both deficiencies in the

design of controls and deficiencies in the operations of controls. Some examples relevant to a compliance audit are as follows:

- Deficiencies in the design of controls
 - Inadequate design of controls over activities subject to a type of compliance requirement
 - Inadequate design of controls over complex types of compliance requirements
 - Insufficient control consciousness within the entity; for example, the tone at the top and the control environment
 - Absent or inadequate segregation of duties over a type of compliance requirement
 - Inadequate design of IT controls relating to the activity subject to the type of compliance requirement
 - Employees or management who lack the qualifications and training to fulfill their assigned functions
 - Inadequate design of monitoring controls used to assess the design and operating effectiveness of the entity's internal control over compliance over time
 - The absence of an internal process to report deficiencies in internal control over compliance to management on a timely basis
- Deficiencies in the operation of controls
 - Failure in the operation of effectively designed controls over a type of compliance requirement
 - Failure of the information and communication component of internal control over compliance to provide complete and accurate output because of deficiencies in timeliness, completeness, or accuracy of information related to compliance
 - Misrepresentation by entity personnel to the auditor (an indicator of fraud)
 - Management override of controls
 - Failure of an application control caused by a deficiency in the design or operation of an IT general control
 - An observed deviation rate that exceeds the number of deviations expected by the auditor in a test of the operating effectiveness of a control

Program Cluster Considerations

9.52 An entity may have separate controls related to federal programs that are treated as a cluster of programs in a Circular A-133 compliance audit, such as student financial aid (SFA) and research and development (R&D). (Chapter 5, "Overview of the Single Audit Act, Circular A-133, and the *Compliance Supplement*," of this guide discusses clusters of programs.) In this case,

when evaluating whether an identified deficiency is a significant deficiency in internal control over compliance, the significance of the deficiency in relation to the type of compliance requirement for the cluster of programs is an important factor. Following are some examples:

- Deficiencies in specific controls over the time cards of college work-study students would likely be considered significant deficiencies in internal control over compliance when college work-study program expenditures are significant in relation to SFA programs.
- Deficiencies in controls over a single campus or department of a university where a significant amount of research was administered would likely be significant deficiencies in internal control over compliance when considered in relation to the total expenditures of R&D programs.
- A deficiency in an SFA or R&D program that was clearly insignificant to the SFA or R&D program, respectively, as a whole would not necessarily be considered a significant deficiency in internal control over compliance.

Documentation Requirements

9.53 As noted in paragraph 39 of SAS No. 117, the auditor should document the risk assessment procedures performed, including those related to gaining an understanding of internal control over compliance. Paragraph 40 of SAS No. 117 states that the auditor should document his or her responses to the assessed risks of material noncompliance, the procedures performed to test compliance with the applicable compliance requirements,⁹ and the results of those procedures, including any test of controls over compliance. Guidance related to this documentation is found in paragraph .122 of AU section 314, which notes that the auditor should document the following related to his or her understanding of internal control related to compliance requirements:

- The discussion among the audit team regarding the susceptibility of the entity's major programs to direct and material noncompliance with compliance requirements, including how and when the discussion occurred, the subject matter discussed, the audit team members who participated, and significant decisions reached concerning planned responses to compliance requirements
- Key elements of the understanding obtained regarding each of the aspects of the entity and its environment, in this case as it relates to internal control over compliance, to assess the risks of material noncompliance, the sources of information from which the understanding was obtained; and the risk assessment procedures performed

⁹ SAS No. 117 defines *applicable compliance requirements* as the compliance requirements that are subject to the compliance audit. Paragraph .500(d) of OMB Circular A-133 states that the auditor should determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that may have a direct and material effect on each of its major programs. Therefore, in a Circular A-133 compliance audit, the direct and material compliance requirements are those that are subject to audit. Accordingly, for the purpose of adapting SAS No. 117 to a Circular A-133 compliance audit, the term *applicable compliance requirements* has been replaced by *direct and material compliance requirements* in this guide except when directly citing content from SAS No. 117.

- The assessment of risks of material noncompliance and the basis for the assessment
- The risks identified and related controls evaluated as a result of the requirements in paragraphs .110 and .117 of AU section 314

9.54 Paragraph .77 of AU section 318 contains requirements regarding documentation of the testing of controls. Among the matters discussed in that guidance that is of particular relevance to a Circular A-133 compliance audit is that the auditor should document the following:

- The overall responses to address the assessed risks of noncompliance as it relates to compliance requirements of major programs
- The nature, timing, and extent of further audit procedures
- The linkage of those procedures with the assessed risks
- The results of the audit procedures

9.55 As noted in chapter 2, "Planning Considerations of *Government Auditing Standards*," of this guide, AU section 339, *Audit Documentation* (AICPA, *Professional Standards*, vol. 1) provides guidance on the form, content, extent, retention, and confidentiality of audit documentation as required by GAAS. Among other things, AU section 339 requires audit documentation to be sufficient to enable an experienced auditor, having no previous connection to the audit, to understand

- the nature, timing, and extent of auditing procedures performed to comply with *Government Auditing Standards* and other applicable standards and requirements, such as Circular A-133 requirements;
- the results of the audit procedures performed and the audit evidence obtained;
- the conclusions reached on significant matters; and
- that the accounting records agree or reconcile with the audited financial statements or other audited financial information.

AU section 339 contains guidance on documenting significant findings or issues; identifying the preparer and reviewer of audit documentation; documenting specific items tested; documenting departures from relevant SASs; revising audit documentation after the date of the auditor's report; and ownership and confidentiality of audit documentation. Paragraph 4.20 of *Government Auditing Standards* includes an additional standard that states that auditors should document, before the report is issued, evidence of supervisory review of the work performed that supports findings, conclusions, and recommendations contained in the audit report.

9.56 The form and extent of this documentation are influenced by the size and complexity of the auditee, as well as the nature of the auditee's internal control over compliance. For example, the documentation of the understanding of internal control over compliance of a large, complex entity may include flowcharts, questionnaires, or decision tables. For a small entity, however, the documentation may be less extensive. In general, the more complex internal control over compliance and the more extensive the procedures performed, the more extensive the auditor's documentation. (See chapter 11 of this guide for more information on documenting the testing of internal control.)

Consideration of Abuse

9.57 As discussed in chapter 3 of this guide, paragraphs 4.10–.13 of *Government Auditing Standards* discuss its additional fieldwork standard that requires auditors to be alert to situations or transactions that could be indicative of abuse.¹⁰ Because the determination of abuse is subjective, auditors are not required to provide reasonable assurance of detecting abuse. However, if auditors become aware of indications of abuse that could be quantitatively or qualitatively material to the financial statement amounts, they should apply audit procedures specifically directed to ascertain whether abuse has occurred and the potential effect on the financial statement amounts or other financial data significant to the audit objectives. That standard, like all of the general, fieldwork, and reporting standards in *Government Auditing Standards*, applies to the entirety of a single audit, including the Circular A-133 compliance audit. Therefore, if in performing procedures on major programs, the auditor becomes aware of a situation or transaction that might constitute abuse, the auditor should extend procedures to determine whether it is indicative of abuse and potentially material to the financial statement amounts¹¹ or to the major program. Chapter 3 of this guide further discusses procedures relating to and the evaluation of indications of abuse and chapter 10 of this guide discusses the nature of abuse as it relates to federal awards. Chapter 13 of this guide discusses the reporting of abuse involving federal awards.

American Recovery and Reinvestment Act Considerations *

9.58 Addendum #1 to the 2009 *Compliance Supplement*[†] provides additional considerations for programs with expenditures of Recovery Act awards that the auditor determines are major programs. This discussion emphasizes several important points related to internal control testwork related to each major program funded with Recovery Act awards as follows:

- It is essential that auditee management establish and maintain internal control designed to reasonably ensure compliance with federal law, regulations, and program compliance requirements, including internal control designed to ensure compliance with Recovery Act requirements. The auditor then performs and documents testwork related to internal control in accordance with Circular A-133.

¹⁰ Paragraph 4.19 of *Government Auditing Standards* describes *abuse* by stating that it is distinct from fraud, illegal acts, and violations of provisions of contracts or grant agreements. Abuse, it states, "involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances."

¹¹ See footnote 3 in paragraph 9.04.

* Information in this guide related to the American Recovery and Reinvestment Act of 2009 (Recovery Act) is based upon the latest information available at the time of this writing. However, this information is subject to change because guidance from the OMB is being issued and updated on an ongoing basis. It is important that recipients of Recovery Act funding, and their auditors, monitor the guidance issued. For the latest OMB guidance, go to the OMB website at www.whitehouse.gov/omb/recovery_default. Information can also be found at the Recovery Act Resource Center on the Governmental Audit Quality Center website, which is open to the public at www.aicpa.org/INTERESTAREAS/GOVERNMENTALAUDITQUALITY/RESOURCES/RECOVERYACTRESOURCECENTER/Pages/default.aspx and at the U.S. Government's official Recovery Act website at www.recovery.gov.

[†] Although Addendum #1 is related to a prior year *OMB Circular A-133 Compliance Supplement*, it contains information that continues to be relevant for audits of entities expending Recovery Act awards.

- It is imperative that deficiencies in internal control over compliance be corrected by management as soon as possible to ensure proper accountability and transparency for expenditures of Recovery Act awards. Auditors are encouraged to promptly inform auditee management and those charged with governance during the audit engagement about deficiencies in internal control over compliance related to Recovery Act funding that are, or are likely to be, significant deficiencies or material weaknesses in internal control over compliance.[‡] This early communication will allow management to expedite corrective action and mitigate the risk of improper expenditures of Recovery Act awards. Auditors should use professional judgment regarding the form of such interim communication, using the guidelines set forth. Regardless of how interim communications are made, the auditor should also communicate Recovery Act related significant deficiencies or material weaknesses in internal control over compliance through the normal reporting process at the end of the audit (for example, the reporting on internal control over compliance and the schedule of findings and questioned costs).
- At many entities, the Recovery Act awards will result in material increases in funding, which may result in a material increase in the level of resources needed by management to properly manage, monitor, and account for Federal awards and effectively operate internal control. As part of the consideration of internal control over compliance, auditors should consider capacity issues as discussed in Part 6 of the *Compliance Supplement*. In addition, when evaluating whether identified deficiencies in internal control, individually or in combination, are significant deficiencies or material weaknesses, the auditor should consider the likelihood and magnitude of noncompliance. One of the factors that affects the magnitude is the volume of activity exposed to the deficiency in the current period or expected in the future.

[‡] The AICPA Auditing Standards Board has issued an interpretation that provides an illustration of how an auditor who decides to early communicate in writing would do so. See Interpretation No. 3, "Communication of Significant Deficiencies and Material Weaknesses Prior to the Completion of the Compliance Audit for Auditors That Are Not Participants in Office of Management and Budget Pilot Project," of AU section 325, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 9325 par .07–.10).

Chapter 10

Compliance Auditing Applicable to Major Programs

Note: The audit required by the Single Audit Act Amendments of 1996 and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, should be performed in accordance with *Government Auditing Standards*. Part I, "Government Auditing Standards Audits" (chapters 2–4 of this guide), discusses financial statement audits under generally accepted auditing standards (GAAS) and *Government Auditing Standards*. The guidance in parts I and II, "Circular A-133 Audits," (chapters 5–14 of this guide), is applicable for those auditors performing an audit under the Single Audit Act Amendments of 1996 and Circular A-133.

Information related to the American Recovery and Reinvestment Act of 2009 (Recovery Act) can be found in a section located at the end of each chapter in part II of this guide. See the section titled "American Recovery and Reinvestment Act Considerations" beginning at paragraph 10.75 in this chapter. See also the preface section titled "Impact of the American Recovery and Reinvestment Act of 2009 on Single Audits."

10.01 This chapter discusses the auditor's consideration of compliance requirements applicable to major programs under Circular A-133. (As discussed in chapter 14, "Program-Specific Audits," of this guide, much of the guidance in this chapter also would be applicable to a program-specific audit when a program-specific audit guide is not available). Chapter 13, "Auditor Reporting Requirements and Other Communication Considerations in a Single Audit," of this guide discusses the related reporting requirements. Chapter 3, "Financial Statement Audit Considerations of *Government Auditing Standards*," and chapter 4, "Auditor Reporting Requirements and Other Communication Considerations of *Government Auditing Standards*," of this guide discuss the auditor's consideration of and reporting on the auditee's compliance with laws, regulations, and provisions of contracts or grant agreements in a financial statement audit.

Compliance Objectives in a Circular A-133 Compliance Audit

10.02 Statement on Auditing Standards (SAS) No. 117, *Compliance Audits* (AICPA, *Professional Standards*, vol. 1, AU sec. 801), states that the auditor's objectives in a compliance audit are to

- obtain sufficient appropriate audit evidence to form an opinion and report at the level specified in the governmental audit requirement on whether the entity complied in all material respects with the

applicable compliance requirements,¹ which are the direct and material compliance requirements in a Circular A-133 compliance audit; and

- identify audit and reporting requirements specified in the governmental audit requirement that are supplemental to GAAS and Government Auditing Standards, if any, and perform procedures to address those requirements.

10.03 Circular A-133 (the governmental audit requirement covered in this guide) states that, in addition to performing a financial statement audit in accordance with GAAS and *Government Auditing Standards*, the auditor should determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that may have a direct and material effect on each of its major programs. A Circular A-133 compliance audit results in the auditor expressing an opinion on the auditee's compliance with those compliance requirements for each of its major programs. To express such an opinion, the auditor accumulates sufficient appropriate audit evidence by planning, performing risk assessment procedures, and performing tests of transactions and such other auditing procedures as are necessary in support of the auditee's compliance with direct and material compliance requirements, thereby limiting audit risk of noncompliance to an appropriately low level.

Responsibilities of Auditee

10.04 Following the guidance in SAS No. 117, the Circular A-133 compliance audit is based on the premise that management is responsible for the entity's compliance with compliance requirements. That responsibility includes the following:

- Identifying the entity's federal programs and understanding and complying with the types of compliance requirements
- Establishing and maintaining effective controls that provide reasonable assurance that the entity administers federal programs in compliance with the types of compliance requirements
- Evaluating and monitoring the entity's compliance with the types of compliance requirements
- Taking corrective action when instances of noncompliance are identified, including corrective action on audit findings of the compliance audit

Paragraphs 10.71–.73 discuss how the auditor has a responsibility to obtain management's written representations regarding its compliance and internal control responsibilities.

¹ Statement on Auditing Standards (SAS) No. 117, *Compliance Audits* (AICPA, *Professional Standards*, vol. 1, AU sec. 801), defines *applicable compliance requirements* as the compliance requirements that are subject to the compliance audit. Paragraph .500(d) of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133), states that the auditor should determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that may have a direct and material effect on each of its major programs. Therefore, in a Circular A-133 compliance audit, the direct and material compliance requirements are those that are subject to audit. Accordingly, for the purpose of adapting SAS No. 117 to a Circular A-133 compliance audit, the term *applicable compliance requirements* has been replaced by *direct and material compliance requirements* in this guide except when directly citing content from SAS No. 117.

10.05 The form and extent of the documentation of management's compliance will vary depending on the nature of the compliance requirements and the size and complexity of the entity. The auditee may have documentation in the form of accounting or statistical data, case files, entity policy manuals, accounting manuals, narrative memorandums, procedural write-ups, flowcharts, completed questionnaires, or internal auditors' reports.

Use of Professional Judgment

10.06 The planning, conduct, and evaluation of the results of compliance testing in a Circular A-133 compliance audit require the auditor to exercise professional judgment. The auditor may consider the following factors in applying his or her professional judgment:

- The assessment of audit risk of noncompliance
- The assessment of materiality
- The evidence obtained from other auditing procedures
- The amount of expenditures for the program
- The diversity or homogeneity of expenditures for the program
- The length of time that the program has operated, or changes in its conditions
- The current and prior auditing experience with the program, particularly findings in previous audits and other evaluations (such as inspections, program reviews, or system reviews required by the Federal Acquisition Regulations found in Part 41 of the *Code of Federal Regulations*)
- The extent to which the program is carried out through subrecipients, as well as the related monitoring activities
- The extent to which the program contracts for goods or services
- The level to which the program already is subject to program reviews or other forms of independent oversight
- The expectation of noncompliance or compliance with the direct and material compliance requirements
- The extent to which computer processing is used to administer the program, as well as the complexity of the processing
- Whether the program has been identified as being higher risk by the OMB in the *OMB Circular A-133 Compliance Supplement (Compliance Supplement)*

Audit Risk of Noncompliance Considerations

10.07 To express an opinion on compliance, the auditor accumulates sufficient appropriate audit evidence in support of compliance, thereby limiting audit risk of noncompliance to an appropriately low level. Requirements and guidance related to the auditor's consideration of audit risk and materiality are found in AU section 312, *Audit Risk and Materiality in Conducting an Audit* (AICPA, *Professional Standards*, vol. 1), and these requirements and guidance should be adapted and applied to the Circular A-133 compliance audit when planning and performing the audit. Audit risk of noncompliance and materiality, among other matters, need to be considered together for each major program

being tested as well as for each direct and material compliance requirement in determining the nature, timing, and extent of auditing procedures and in evaluating the results of those procedures. See chapter 6, "Planning Considerations of Circular A-133," of this guide for a discussion of audit risk of noncompliance considerations, including a detailed description of the components of audit risk of noncompliance, performing risk assessment procedures, and assessing the risks of noncompliance.

Performing Further Audit Procedures in Response to Assessed Risks

10.08 The auditor should design and perform further audit procedures, including tests of details (which may include tests of transactions) to obtain sufficient appropriate audit evidence about the auditee's compliance with each of the direct and material compliance requirements in response to the assessed risks of material noncompliance. Risk assessment procedures, tests of controls, and analytical procedures alone are not sufficient to address a risk of material noncompliance.

10.09 If risks of material noncompliance are identified that are pervasive to the entity's compliance, the auditor should develop an overall response to such risks. Paragraphs .04–.06 of AU section 318, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* (AICPA, *Professional Standards*, vol. 1), which should be adapted and applied to the compliance audit, provides further guidance in developing an overall response to the risks of material noncompliance.

Materiality Considerations

10.10 As discussed in chapter 6 of this guide, the auditor's consideration of materiality in a Circular A-133 compliance audit differs from that in an audit of the financial statements. Materiality is affected by (a) the nature of the compliance requirements, which may or may not be quantifiable in monetary terms; (b) the nature and frequency of noncompliance identified with an appropriate consideration of sampling risk; and (c) qualitative considerations, such as the needs and expectations of federal agencies and pass-through entities.

Materiality Judgments About Compliance Applied to Each Major Program Taken as a Whole

10.11 SAS No. 117 states that the auditor should establish and apply materiality levels for the compliance audit based on the governmental audit requirement. Therefore, in designing audit tests and developing an opinion on the auditee's compliance with direct and material compliance requirements in a Circular A-133 compliance audit, the auditor should apply the concept of materiality to each major program taken as a whole, rather than to all major programs combined.

10.12 For purposes of evaluating the results of compliance testing, a material instance of noncompliance is defined as a failure to follow requirements, or a violation of prohibitions, established by law, regulation, contract, or grant agreement that results in an aggregation of noncompliance (that is, the auditor's best estimate of the overall noncompliance) that is material to the affected federal program. Instances of noncompliance that may not be individually material should be assessed to determine if, in the aggregate, they could have a

material effect. Because the auditor expresses an opinion on each major program and not on all the major programs combined, reaching a conclusion about whether the instances of noncompliance (either individually or in the aggregate) are material to a major program requires consideration of the type and nature of the noncompliance, as well as the actual and projected effect on each major program in which the noncompliance was noted. Instances of noncompliance that are material to one major program may not be material to a major program of a different size or nature. In addition, the level of materiality relative to a particular major program can change from one audit to the next.

Effect of Material Noncompliance on the Financial Statements

10.13 If the tests of compliance reveal material noncompliance at the major program level, the auditor should consider its effect on the financial statements. The auditor also should consider the cumulative effect of all instances of noncompliance on the financial statements using the materiality level established for the basic financial statements.² (See also paragraph 10.55 and chapter 12, "Audit Considerations of Federal Pass-Through Awards," of this guide.)

Performing a Circular A-133 Compliance Audit

10.14 The auditor should exercise (a) due care in planning and performing the audit and in evaluating the results of his or her audit procedures, and (b) a proper degree of professional skepticism to achieve reasonable assurance that material noncompliance will be detected.

10.15 In a Circular A-133 compliance audit, the auditor should perform the following, as discussed in paragraphs 10.16–.69:

- a. Identify the auditee's major programs to be tested and reported on for compliance
- b. Identify the compliance requirements applicable to each major program
- c. Determine which of the compliance requirements identified in step (b) could have a direct and material effect on each major program
- d. Plan the engagement
- e. Consider relevant portions of the entity's internal control over compliance for each direct and material compliance requirement for each program
- f. Obtain sufficient appropriate audit evidence, which involves testing internal control over compliance and compliance with direct and material compliance requirements for each major program
- g. Consider indications of abuse
- h. Consider subsequent events
- i. Form an opinion about whether the auditee complied with the direct and material compliance requirements
- j. Perform follow-up procedures on previously identified findings

² As discussed in the Audit and Accounting Guide *State and Local Governments* the auditor's consideration of materiality for purposes of planning, performing, evaluating the results of, and reporting on the audit of the financial statements of a state or local government is based on opinion units.

Identifying Major Programs to Be Tested

10.16 Circular A-133 states that the auditor should determine the major programs to be tested using a risk-based approach, applying a specific process established in the circular. Chapter 8, "Determination of Major Programs," of this guide discusses the application of the risk-based approach to determine major programs.

Identifying Direct and Material Compliance Requirements

10.17 As discussed in this section, the auditor should determine, after identifying the compliance requirements applicable to each major program, the direct and material compliance requirements to be tested and reported on in a Circular A-133 compliance audit. As further described in paragraph 10.19, Part 2 of the *Compliance Supplement* provides a matrix that is useful to the auditor in identifying whether particular types of compliance requirements may apply to federal programs. The auditor then assesses, based on the nature of the program and the transactions for the period under audit, those types of compliance requirements that may have a direct and material effect on each major program. The auditor should use professional judgment in making this determination.

Compliance Supplement

10.18 The *Compliance Supplement* is based on the requirements of the Single Audit Act Amendments of 1996 and Circular A-133, which provide for the issuance of a compliance supplement to assist auditors in performing the required audits. (Chapter 5, "Overview of the Single Audit Act, Circular A-133, and the *Compliance Supplement*," discusses the *Compliance Supplement* and how to obtain it.) The *Compliance Supplement* is a comprehensive source of information regarding compliance. Part 1 of the *Compliance Supplement* includes background, purpose, and applicability information, and Part 2 provides a matrix of types of compliance requirements that are applicable to the programs included in the supplement. Part 3 of the *Compliance Supplement* identifies the 14 types of compliance requirements applicable to most federal programs, as listed in paragraph 10.19. Part 4 of the *Compliance Supplement* includes a discussion of the compliance requirements specific to certain of the largest federal programs, and Part 5 contains information on clusters of programs. Part 6 of the *Compliance Supplement* discusses internal control as it relates to the types of compliance requirements. As further discussed in paragraph 10.27, Part 7 of the *Compliance Supplement* provides guidance to assist the auditor in identifying the types of compliance requirements for federal programs not included in the *Compliance Supplement*.

Fourteen Types of Compliance Requirements

10.19 Part 3 of the *Compliance Supplement* lists and describes the 14 types of compliance requirements and the related audit objectives that the auditor should consider in every Circular A-133 compliance audit, with the exception of program-specific audits performed in accordance with a federal agency's program specific audit guide (see chapter 14). It also provides suggested audit procedures to assist the auditor in planning and performing tests of the auditee's compliance with the requirements of federal programs. The auditor's judgment will be necessary to determine whether the suggested audit procedures are sufficient to achieve the stated audit objectives and whether additional or

alternative audit procedures are needed (see paragraph 10.43). The 14 types of compliance requirements are as follows:

- A—Activities allowed or unallowed
- B—Allowable costs/cost principles
- C—Cash management
- D—Davis-Bacon Act
- E—Eligibility
- F—Equipment and real property management
- G—Matching, level of effort, earmarking
- H—Period of availability of federal funds
- I—Procurement and suspension and debarment
- J—Program income
- K—Real property acquisition and relocation assistance
- L—Reporting
- M—Subrecipient monitoring
- N—Special tests and provisions

The auditor should consider the applicability of these types of compliance requirements to the auditee's major programs. Part 2 of the *Compliance Supplement* provides a matrix that is useful to the auditor for this purpose; that matrix identifies whether particular types of compliance requirements may apply to the federal programs included in the *Compliance Supplement*. In making a determination not to test a type of compliance requirement identified as applicable to a particular program, the auditor should conclude, and document such conclusion, either that the requirement does not apply to the particular auditee or that noncompliance with the requirements could not have a direct and material effect on a major program. For example, a federal program may be designed such that it potentially may be used to purchase real property, among other things, and thus the matrix in Part 2 of the *Compliance Supplement* would identify the real property acquisition and relocation assistance type of compliance requirement as applicable. However, the auditee may not have expended any, or expended only an immaterial amount, of their federal program funds on real property and thus the auditor may determine that the real property acquisition and relocation assistance type of compliance requirement would not be direct or material (even though it was identified as applicable in the Part 2 matrix). No testing would be required on types of compliance requirements not considered direct and material, but the auditor's conclusion relating to this determination should be documented.

Keeping Abreast of Changes in Compliance Requirements

10.20 Circular A-133 states that an audit of the compliance requirements related to federal programs contained in the *Compliance Supplement* will meet the requirements of the circular. However, it also states that when there have been changes to the compliance requirements and the changes are not reflected in the *Compliance Supplement*, the auditor should determine the current compliance requirements and modify the audit procedures accordingly.

10.21 Although Circular A-133 provides that federal agencies are responsible for informing the OMB annually of any updates needed to the *Compliance Supplement*, laws and regulations change periodically and delays will occur

between such changes and revisions to the *Compliance Supplement*. Accordingly, the auditor should perform reasonable procedures to ensure that compliance requirements are current. Besides describing the types of compliance requirements, the *Compliance Supplement* includes references to the *Code of Federal Regulations* and other sources of information about the requirements. The auditor may refer to those other sources of information to identify significant changes to the requirements or perform other procedures, including the following:

- Hold discussions with appropriate individuals within the auditee organization (that is, the CFO, internal auditors, legal counsel, compliance officer, or grant or contract administrators)
- Review contracts or grant agreements, new guidance material issued by the granting agency or pass-through entity (for example, handbooks and operating procedures), and correspondence from the granting agency or pass-through entity
- Make inquiries of granting agency personnel (A listing of federal agency contacts, including addresses, phone numbers, and e-mail or Internet site addresses can be found in *Compliance Supplement* appendix 3.)

Considering Additional Provisions of Contracts or Grant Agreements

10.22 The *Compliance Supplement* states that in addition to the compliance requirements identified in the supplement, auditors should consider whether there are any provisions of contracts or grant agreements that are unique to a particular entity. For example, the grant agreement may specify the matching percentage, or an entity may have agreed to additional requirements that are not required by law or regulation, perhaps as part of a resolution of prior audit findings.

10.23 Therefore, in using the *Compliance Supplement* to identify direct and material compliance requirements, the auditor should consider

- a. the applicability to the federal program of the 14 types of compliance requirements identified in Part 3 of the *Compliance Supplement*.
- b. additional compliance requirements specific to the federal program as identified in Part 4 of the *Compliance Supplement*.
- c. any provisions of contracts or grants that are unique to the particular entity.

Compliance Requirements Specific to Certain Federal Programs

10.24 Part 4 of the *Compliance Supplement* discusses program objectives, program procedures, and compliance requirements that are specific to each federal program included. With the exception of special tests and provisions, Part 3 of the *Compliance Supplement* identifies the audit objectives and suggested audit procedures that pertain to the compliance requirements associated with each program. Because special tests and provisions are unique to each program, Part 4 of the *Compliance Supplement* includes those compliance requirements and the related audit objectives and suggested audit procedures. (Part 4 of the *Compliance Supplement* is considered a supplement to Part 3 and is not a replacement for it.)

Compliance Requirements Specific to a Cluster of Programs

10.25 As discussed in chapter 5 of this guide, a cluster of programs is a grouping of closely related programs that have similar compliance requirements (for example, Student Financial Assistance [SFA], research and development [R&D], and other clusters). Part 5 of the *Compliance Supplement* identifies those programs that the OMB considers clusters of programs. It also provides compliance requirements, audit objectives, and suggested audit procedures for the SFA and R&D clusters. (States also may designate clusters of programs for federal awards they provide to subrecipients when those awards are for groupings of closely related programs that have similar compliance requirements.)

Relationship of the Compliance Supplement to Federal Program Audit Guides

10.26 The *Compliance Supplement* states that when performing an audit in accordance with Circular A-133, the supplement replaces federal agency audit guides and other audit requirement documents for individual federal programs.³ Accordingly, for a federal program included in the *Compliance Supplement* and having a separate federal program audit guide or other federal program audit requirement documents, the auditor needs to consider only those types of compliance requirements in the *Compliance Supplement* when performing a Circular A-133 compliance audit (versus a program-specific audit).

Federal Programs Not Included in the Compliance Supplement

10.27 The *Compliance Supplement* does not include all federal programs from which an auditee may receive federal awards. Circular A-133 states that for those federal programs not covered in the *Compliance Supplement*, the auditor should use the 14 types of compliance requirements (see paragraph 10.19) contained in the supplement as guidance for identifying the types of compliance requirements to test, and should determine the requirements governing the federal program by reviewing the provisions of contracts and grant agreements and the laws and regulations referred to in such contracts and grant agreements. The auditor should follow the guidance in Part 7 of the *Compliance Supplement* for identifying the direct and material compliance requirements to test and report on in a Circular A-133 compliance audit. That guidance outlines the following steps to determine which compliance requirements to test:

- a. Identify the compliance requirements that are applicable to the federal program.
- b. Determine which of the compliance requirements identified in step a could have a direct and material effect on the major program.
- c. Determine which of the compliance requirements identified in step b are susceptible to testing by the auditor.

³ Some federal agencies have developed audit guides or supplements related to their programs. For programs not listed in the *OMB Circular A-133 Compliance Supplement (Compliance Supplement)*, the auditor may wish to consider that guidance in identifying the program objectives, program procedures, and compliance requirements, as suggested in Part 7 of the *Compliance Supplement*. That guidance, where available, may be obtained from the federal agency's Office of Inspector General. Auditors should consider whether such guidance is outdated with regard to compliance requirements or currently authoritative auditing standards and requirements. See the discussion regarding such situations in chapter 14, "Program-Specific Audits," of this guide.

- d. Determine which of the 14 types of compliance requirements the compliance requirements identified in step c fall into.
- e. For special tests and provisions, determine the applicable audit objectives and audit procedures.

Part 7 of the *Compliance Supplement* provides more detailed guidance on the steps to perform to identify direct and material compliance requirements.

Planning the Engagement

General Considerations

10.28 Planning a Circular A-133 compliance audit involves developing an overall strategy for the expected conduct and scope of the engagement. To develop such a strategy, auditors need to have sufficient knowledge to enable them to understand adequately the events, transactions, and practices that, in their judgment, have a significant effect on compliance. Also, it is important for auditors to gain an understanding of any additional audit requirements that are supplemental to GAAS and *Government Auditing Standards*. Proper planning and supervision contribute to the effectiveness of audit procedures. Proper planning directly influences the selection of appropriate procedures and the timeliness of their application, and proper supervision helps ensure that planned procedures are appropriately applied. (See also chapter 6 of this guide.)

10.29 Factors the auditor might consider in planning a Circular A-133 compliance audit include (a) the anticipated level of audit risk of noncompliance related to the direct and material compliance requirements on which the auditor will report (see paragraph 10.07–.09), (b) preliminary judgments about materiality levels for audit purposes (see paragraphs 10.10–.13), and (c) conditions that may require the extension or modification of audit procedures.

10.30 The nature, timing, and extent of planning will vary with the nature and complexity of the compliance requirements and the auditor's prior experience with the auditee. The auditor must plan the audit so that it is responsive to the assessment of the risks of material noncompliance based on the auditor's understanding of the entity and its environment, including its internal control. As the Circular A-133 compliance audit progresses, changed conditions may make it necessary to modify planned procedures. Chapter 6 of this guide discusses additional planning considerations.

Multiple-Component Considerations

10.31 In a Circular A-133 compliance audit in which the auditee has operations in multiple-components (for example, organizational units, locations or branches), the auditor may determine that it is not necessary to test compliance with requirements at every such unit. Making such a determination and selecting the units to be tested includes consideration of the following factors: (a) the degree to which the specified compliance requirements apply at the organizational unit; (b) judgments about materiality; (c) the degree of centralization of the records; (d) the effectiveness of controls, particularly those that affect management's direct control over the exercise of authority delegated to others, as well as its ability to supervise activities at various locations effectively; (e) the nature and extent of operations conducted at the various organizational units; and (f) the similarity of operations and controls over compliance for different organizational units. Chapters 8–9 and 11 "Audit Sampling Considerations

of Circular A-133 Compliance Audits," of this guide discuss other multiple-component considerations.

Consideration of Internal Control Over Compliance for Major Programs

10.32 For each of the direct and material compliance requirements for each major program, the auditor should obtain an understanding of relevant portions of internal control over compliance sufficient to plan the audit and to assess control risk of noncompliance⁴ with respect to compliance with those requirements. In planning the audit, the auditor should use this knowledge to identify types of potential noncompliance, to consider factors that affect the risks of material noncompliance, and to design appropriate tests of compliance. Circular A-133 specifically states that the auditor should perform procedures to obtain an understanding of internal control over compliance for federal programs sufficient to plan the audit to support a low assessed level of control risk for major programs. Circular A-133 also states that the auditor should perform testing of controls as planned. In some instances, the auditor may be able to perform compliance testing for major programs concurrently with tests of controls.⁵ (Chapter 6 of this guide discusses how to develop an efficient audit approach.) Any significant deficiencies in internal control over compliance for major programs that are noted should be reported as an audit finding. (Chapter 13 of this guide discusses the situations that Circular A-133 requires the auditor to report as audit findings.) Chapter 6 of this guide further discusses control risk of noncompliance, and chapter 9, "Consideration of Internal Control Over Compliance for Major Programs," of this guide discusses the auditor's consideration of internal control over compliance for major programs, including the final control risk of noncompliance assessment and the performance of tests of controls.

Performing Compliance Testing⁶

10.33 In planning the audit, the auditor should use knowledge gained in the inherent risk of noncompliance assessment process (as described in chapter 6 of this guide) to (a) identify types of potential noncompliance, (b) to consider other factors that affect the risks of material noncompliance, and (c) to design appropriate tests of compliance to reduce the risk of significant noncompliance to a sufficiently low level.

10.34 As described in chapter 9 of this guide, Circular A-133 specifically requires the auditor to perform procedures to obtain an understanding of internal control over compliance for federal programs sufficient to plan the audit to support a low assessed level of control risk for major programs. This includes performing procedures to evaluate the design and operating effectiveness of the internal control over compliance for each direct and material compliance requirement for each major program.

⁴ In part II of this guide, the term *control risk of noncompliance* is used in order to be consistent with the term as used and defined in SAS No. 117. The term *control risk* is used only when directly citing Circular A-133. Both terms have the same meaning.

⁵ However, see paragraph 6.55 for additional considerations.

⁶ See chapter 11, "Audit Sampling Considerations of Circular A-133 Compliance Audits," for an in-depth discussion of audit sampling in a compliance audit, including a discussion of performing compliance testing for major programs concurrently with tests of controls (that is, dual purpose testing).

10.35 Circular A-133 states that compliance testing should include tests of transactions and such other auditing procedures as are necessary to provide the auditor with sufficient evidence to support an opinion on compliance for each major program. Such compliance testing may be performed (a) concurrently with tests of controls, (b) as substantive testing, or (c) as a combination of the two. In performing compliance testing, the auditor attempts to obtain reasonable assurance that the auditee complied, in all material respects, with the compliance requirements. In a Circular A-133 compliance audit this includes designing procedures to detect both intentional and unintentional noncompliance. The auditor can obtain reasonable, but not absolute, assurance about the entity's compliance because of factors such as the need for judgment, the use of sampling, and the inherent limitations of internal control over compliance with direct and material compliance requirements and the fact that much of the evidence available to the auditor is persuasive rather than conclusive in nature. Also, procedures that are effective for detecting noncompliance that is unintentional may be ineffective for detecting noncompliance that is intentional and is concealed through collusion between the auditee's personnel and a third party or among the management or other employees of the entity. Therefore, the subsequent discovery that material noncompliance with direct and material compliance requirements exists does not, in and of itself, evidence inadequate planning, performance, or judgment on the part of the auditor.

10.36 In determining the nature, timing, and extent of tests to perform, the auditor should exercise professional judgment regarding the appropriate level of detection risk of noncompliance to accept.⁷ (Paragraph 10.06 notes factors for the auditor to consider in applying professional judgment.) In determining the nature, timing, and extent of the testing of an auditee's compliance with compliance requirements, the auditor should consider both audit risk of noncompliance and materiality related to each major program as well as for each direct and material compliance requirement related to each major program. The auditor plans compliance tests to reduce detection risk of noncompliance to an acceptable level. The evidence provided by those tests, along with evidence regarding inherent risk of noncompliance and control risk of noncompliance, provides the basis for expressing an opinion on whether the auditee complied, in all material respects, with the direct and material compliance requirements for each major program.

10.37 In determining the nature of tests of compliance with requirements governing major programs, the consideration of the nature of those requirements will assist the auditor. For example, to test compliance with requirements applicable to the allowability of expenditures using program funds, the auditor should design audit procedures to provide sufficient appropriate audit evidence to evaluate how management expended the funds.

Sufficient Appropriate Audit Evidence

10.38 The auditor should apply procedures to provide reasonable assurance of detecting material noncompliance. The selection and application of procedures that will accumulate evidence that is sufficient and appropriate in the circumstances to provide a reasonable basis for expressing an opinion on compliance require the careful exercise of professional judgment. A broad array of available procedures may be applied in a Circular A-133 compliance audit.

⁷ See also chapter 11 of this guide for a discussion of audit sampling.

In establishing a proper combination of procedures to restrict audit risk of noncompliance appropriately, the auditor should consider the following generalizations, bearing in mind that they are not mutually exclusive and may be subject to important exceptions:

- a. Audit evidence is more reliable when it is obtained from knowledgeable independent sources outside the entity.
- b. Audit evidence that is generated internally is more reliable when the related controls imposed by the entity are effective.
- c. Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, in-inquiry about the application of a control).
- d. Audit evidence is more reliable when it exists in documentary form, whether paper, electronic, or other medium (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).
- e. Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles.

10.39 Thus, in the hierarchy of available audit procedures, those that involve search and verification (for example, inspection, confirmation, or observation)—particularly when independent sources outside the entity are used—generally are more effective in reducing audit risk of noncompliance than are those involving internal inquiries and comparisons of internal information (for example, analytical procedures and discussions with the individuals responsible for compliance).

10.40 In a Circular A-133 compliance audit, the auditor's objective is to accumulate sufficient appropriate audit evidence to limit audit risk of noncompliance to a level that is, in the auditor's professional judgment, appropriately low for the high level of assurance being provided. An auditor should select from all available procedures (that is, procedures that assess inherent and control risk of noncompliance and restrict detection risk of noncompliance) in any combination that can limit audit risk of noncompliance to such an appropriately low level.

10.41 For regulatory requirements, the auditor's procedures may include reviewing reports of significant examinations and related communications between regulatory agencies and the entity and, when appropriate, making inquiries of the regulatory agencies, including inquiries about examinations in progress.

Audit Objectives

10.42 As noted in paragraph 10.19, the *Compliance Supplement* contains the audit objectives for each type of compliance requirement that the auditor should consider in planning and performing tests of compliance requirements. The audit objectives are useful in understanding the specific objectives to be satisfied when the auditor performs audit tests and determines whether the noncompliance that is identified is material.

Suggested Audit Procedures

10.43 The *Compliance Supplement* contains suggested audit procedures for testing federal programs for compliance. Those suggested audit procedures

represent procedures that may be used by the auditor in developing an audit plan. The suggested audit procedures also may be useful in testing the same types of compliance requirements for programs that are not included in the *Compliance Supplement*. The auditor should use professional judgment in determining the audit procedures to be performed to allow him or her to obtain sufficient appropriate audit evidence to form an opinion on the auditee's compliance with the compliance requirements that could have a direct and material effect on each major program.

Audit Sampling

10.44 The auditor generally uses audit sampling to obtain audit evidence. See chapter 11 of this guide for an in-depth discussion of audit sampling as it relates to compliance audits.

Consideration of Abuse

10.45 As discussed in chapter 3 of this guide, paragraphs 4.10–.13 of *Government Auditing Standards* discuss its additional fieldwork standard that requires auditors to be alert to situations or transactions that could be indicative of abuse.⁸ Because the determination of abuse is subjective, auditors are not required to provide reasonable assurance of detecting abuse. However, if auditors become aware of indications of abuse that could be quantitatively or qualitatively material to the financial statement amounts, they should apply audit procedures specifically directed to ascertain whether abuse has occurred and the potential effect on the financial statement amounts or other financial data significant to the audit objectives. That standard, like all of the general, fieldwork, and reporting standards in *Government Auditing Standards*, applies to the entirety of the single audit, including the Circular A-133 compliance audit. Therefore, if in performing procedures on major programs, the auditor becomes aware of a situation or transaction that might constitute abuse, the auditor should extend procedures to determine whether it is indicative of abuse and potentially material to the financial statement amounts⁹ or to the major program. (Chapter 3 of this guide further discusses procedures relating to and the evaluation of indications of abuse.) Because the OMB cost principles circulars require that costs charged to federal awards be reasonable and necessary for the performance and administration of the awards,¹⁰ situations or transactions involving federal awards that might otherwise appear to constitute abuse instead generally are instances of noncompliance. (By definition, instances of noncompliance—illegal acts and violations of provisions of contracts or grant agreements—are not abuse.) However, there may be isolated situations or transactions involving federal awards that the auditor becomes aware of that do constitute abuse. Chapter 13 of this guide discusses the reporting of abuse involving federal awards.

⁸ Paragraph 4.12 of *Government Auditing Standards* describes *abuse* by stating that it is distinct from fraud, illegal acts, and violations of provisions of contracts or grant agreements. Abuse, it states, "involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances."

⁹ See footnote 2.

¹⁰ This compliance requirement is explained in Part 3, "Compliance Requirements," of the *Compliance Supplement*, Section B, "Allowable Costs/Cost Principles."

Consideration of Subsequent Events

10.46 In a Circular A-133 compliance audit, two types of subsequent events may occur. The first type consists of events that provide additional evidence with respect to conditions that existed at the end of the reporting period that affect the auditee's compliance during the reporting period. The second type consists of events of noncompliance that did not exist at the end of the reporting period but arose subsequent to the reporting period.

10.47 The auditor should perform audit procedures up to the date of the auditor's report to obtain sufficient appropriate audit evidence that all subsequent events related to the auditee's compliance during the period covered by the auditor's report on compliance have been identified. The auditor should take into account the auditor's risk assessment in determining the nature and extent of such audit procedures. These procedures should include, but are not limited to, inquiring of management about and considering

- relevant internal auditors' reports issued during the subsequent period,
- other auditors' reports identifying noncompliance that were issued during the subsequent period,
- reports from grantors and pass-through entities related to the auditee's noncompliance that were issued during the subsequent period, and
- information about the auditee's noncompliance obtained through other professional engagements performed for that entity.

10.48 The auditor has no obligation to perform any audit procedures related to the entity's compliance during the period subsequent to the period covered by the auditor's report. However, if before the report release date the auditor becomes aware of noncompliance in the period subsequent to the period covered by the auditor's report that is of such a nature and significance that its disclosure is needed to prevent report users from being misled, the auditor should discuss the matter with management and, if appropriate, those charged with governance and should include an explanatory paragraph in his or her report describing the nature of the noncompliance. An example of a matter of noncompliance that may occur subsequent to the period being audited but before the report release date that may warrant disclosure to prevent report users from being misled is the discovery of noncompliance in the subsequent period of such magnitude that it caused the grantor to stop funding the program.

Evaluation and Reporting of Noncompliance

Instances of Noncompliance (Findings)

10.49 The auditor's tests of compliance with compliance requirements may disclose instances of noncompliance. Circular A-133 refers to these instances of noncompliance, among other matters, as "findings." Such findings may be of a monetary nature and involve questioned costs or may be nonmonetary and not result in questioned costs. Both *Government Auditing Standards* and Circular

A-133 specify how certain findings are to be reported.¹¹ Chapter 13 of this guide discusses the auditor's opinion on compliance and his or her responsibilities for reporting findings.

10.50 Furthermore, the auditor should not assume that an instance of fraud or error is an isolated occurrence, and therefore should consider how the detection of such noncompliance affects the assessed risks of material noncompliance. Before the conclusion of the audit, the auditor should evaluate whether audit risk of noncompliance has been reduced to an appropriately low level and whether the nature, timing, and extent of the audit procedures need to be reconsidered. The auditor should conclude whether sufficient appropriate audit evidence has been obtained to reduce to an appropriately low level the risks of material noncompliance with compliance requirements.

Compliance Opinion

10.51 The auditor should evaluate the sufficiency and appropriateness of the audit evidence obtained. Additionally, the auditor should consider all relevant audit evidence regardless of whether it appears to corroborate or to contradict the relevant assertions.

10.52 SAS No. 117 states that the auditor should form an opinion at the level specified by the governmental audit requirement. In a Circular A-133 compliance audit, the auditor should report on compliance, which includes an opinion (or disclaimer of opinion) as to whether the auditee complied with laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on each major program. Note that Circular A-133 also requires the auditor to prepare a schedule of findings and questioned costs. (Chapter 13 of this guide discusses that report and schedule.) In forming an opinion, SAS No. 117 also states that the auditor should evaluate likely questioned costs, not just known questioned costs, as well as other material noncompliance that, by its nature, may not result in questioned costs.

10.53 In determining whether the auditee complied with the direct and material compliance requirements in all material respects, the auditor may consider the following factors:

- The frequency of noncompliance with the direct and material compliance requirements identified during the compliance audit
- The nature of the noncompliance with the direct and material compliance requirements
- The adequacy of the entity's system for monitoring compliance with the direct and material compliance requirements and the possible effect of any noncompliance on the entity
- Whether any identified noncompliance with the direct and material compliance requirements resulted in likely questioned costs that are material to the federal program

The auditor's evaluation of whether the auditee materially complied with the direct and material compliance requirements includes consideration of

¹¹ Certain laws and regulations may require audit reports to be made publicly available; therefore, the auditor is cautioned not to include names, Social Security numbers, other personal identification, or other potentially sensitive information in the body of audit reports or any attached or referenced schedules or letters.

noncompliance identified by the auditor, regardless of whether the entity corrected the noncompliance after the auditor brought it to management's attention.

10.54 Assessing materiality at the appropriate level is critical to the proper evaluation of findings. Paragraphs 10.10–.13 discuss materiality as it relates to expressing an opinion on the auditee's compliance. Paragraph 10.57 discusses the auditor's evaluation of the effect of questioned costs on the compliance opinion.

Financial Statement Effect

10.55 The auditor also has the responsibility of assessing the effect of the actual and likely error noted in the Circular A-133 compliance audit against the materiality level established for the basic financial statements (see paragraph 10.13). Consideration of the effect of the following items is part of this evaluation: (a) any contingent liability that may arise from the noncompliance in accordance with applicable Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 450, *Contingencies*, or Governmental Accounting Standards Board (GASB) standards (for example, GASB Statement No. 33,¹² *Accounting and Financial Reporting for Nonexchange Transactions*), and (b) for nongovernmental entities, any uncertainty regarding the resolution of instances of noncompliance in accordance with FASB standards (for example, FASB ASC 275, *Risks and Uncertainties*).

Questioned Costs

10.56 Circular A-133 defines *questioned costs* to include costs that are questioned by the auditor because of an audit finding (a) that resulted from a violation or possible violation of a provision of a law, regulation contract, grant, cooperative agreement, or other agreement or document governing the use of federal funds, including funds used to match federal funds; (b) for which the costs, at the time of the audit, are not supported by adequate documentation; or (c) for which the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.

Evaluating the Effect of Questioned Costs on the Compliance Opinion

10.57 In evaluating the effect of questioned costs on the opinion on compliance, the auditor considers the best estimate of the total costs questioned for each major program (likely questioned costs), not just the questioned costs specifically identified (known questioned costs). Likely questioned costs are developed by extrapolating from audit evidence obtained, for example, by projecting known questioned costs identified in an audit sample to the entire population from which the sample was drawn. There may be situations in which the known questioned costs are not considered material but the likely questioned costs are considered material. In those situations, the auditor should consider the noncompliance to be material (and report a finding) or may expand the scope of the Circular A-133 compliance audit and apply additional audit procedures

¹² Governmental Accounting Standards Board Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, as amended, provides standards for the recognition and reporting of refunds of nonexchange revenues by a state or local government when the government does not meet a provider's requirements.

to further establish the likely questioned costs. (See also paragraph 10.62 of this guide.)

Federal Agency Consideration of Findings and Questioned Costs

10.58 The auditor's designation of a cost as questioned does not necessarily mean that a federal grantor agency will disallow the cost. In most instances, the auditor is unable to determine whether a federal awarding agency or pass-through entity will ultimately disallow a questioned cost, because the agency or entity has considerable discretion in those matters.

10.59 Circular A-133 defines a management decision as the evaluation by the federal awarding agency or pass-through entity of the audit findings and corrective action plan and the issuance of a written decision about what corrective action is necessary. (Chapter 13 of this guide discusses the corrective action plan.) Circular A-133 allows a federal awarding agency or pass-through entity receiving an auditor's report indicating findings and questioned costs six months after receipt of the audit report to issue such a decision. The awarding agency or pass-through entity considers the nature of the questioned costs, as well as the amounts involved, in issuing a management decision and deciding whether to disallow them. In addition, most federal awarding agencies have established appeal and adjudication procedures for questioned costs. Because of the discretion allowed in resolving these matters, all questioned costs are subject to uncertainty regarding their resolution.

Reporting the Findings

10.60 As discussed in chapter 6 of this guide, Circular A-133 states that the auditor should consider a different level of materiality for the purposes of reporting audit findings. Circular A-133 states that the auditor, in addition to providing an opinion on compliance, should include the following, among other items, in the schedule of findings and questioned costs:

- Material noncompliance with the provisions of laws, regulations, contracts, or grant agreements related to a major program. The auditor's determination of whether noncompliance with the provisions of laws, regulations, contracts, or grant agreements is material for purpose of reporting an audit finding is in relation to a type of compliance requirement for a major program or an audit objective identified in the *Compliance Supplement*.
- Known questioned costs that are greater than \$10,000 for a type of compliance requirement for a major program. (Paragraph 10.19 lists the 14 types of compliance requirements.) Known questioned costs are those specifically identified by the auditor.
- Known questioned costs when likely questioned costs are greater than \$10,000 for a type of compliance requirement.
- Known questioned costs that are greater than \$10,000 for a federal program that is not audited as a major program.

Chapter 13 of this guide discusses the reporting of audit findings and contains a complete listing of the items that Circular A-133 requires to be reported

in the schedule of findings and questioned costs. That chapter also discusses the requirement from paragraph 5.16 of *Government Auditing Standards* that the auditor communicate to the auditee in writing violations of provisions of contracts or grant agreements that are more than inconsequential but less than material.¹³

Findings of Noncompliance That Cannot Be Quantified

10.61 The auditor may discover instances of noncompliance that cannot be quantified. The auditor's responsibility for reporting such findings can best be described through an example. Assume that the auditor encounters a pass-through entity that consistently fails to provide its subrecipients with federal award information. Circular A-133 requires the auditor to consider noncompliance findings in relation to a type of compliance requirement (in the example provided, subrecipient monitoring is the relevant type of compliance requirement) or an audit objective identified in the *Compliance Supplement*. The pertinent audit objective included in the *Compliance Supplement* and relating to the example provided here is for the auditor to "determine whether the pass-through entity identifies federal award information and compliance requirements to the subrecipient." Because the pass-through entity failed to provide federal award information to its subrecipients, this noncompliance would be material in relation to the audit objective and, therefore, should be reported as an audit finding. In addition, the auditor also should consider whether significant deficiencies in internal control over compliance exist and require reporting with respect to subrecipient monitoring.

Reporting Based on Likely Questioned Costs

10.62 When evaluating the effect of questioned costs on the opinion on compliance, the auditor considers both known questioned costs and the best estimate of the total costs questioned (likely questioned costs). Known and likely questioned costs also need to be considered when audit findings are reported. In addition to reporting known questioned costs greater than \$10,000 for a type of compliance requirement for a major program in the schedule of findings and questioned costs, the auditor also should report known questioned costs when likely questioned costs for a type of compliance requirement for a major program are greater than \$10,000. For example, if the auditor specifically identifies \$7,000 in questioned costs for a type of compliance requirement for a major program but, based on his or her evaluation of the effect of questioned costs for that compliance requirement estimates that the total questioned costs are in the \$50,000 to \$60,000 range, the auditor would report a finding that indicates the known questioned costs of \$7,000. Chapter 13 of this guide further discusses reporting findings based on likely questioned costs.

¹³ Generally, *Government Auditing Standards* requires the auditor to evaluate findings for the purpose of required communications based on their consequence to the financial statements or other financial data significant to the audit objectives. As discussed in chapter 13, "Auditor Reporting Requirements and Other Communication Considerations in a Single Audit," of this guide, however, in an audit in accordance with Circular A-133, the auditor should evaluate findings involving federal awards for the purpose of that communication based only on their consequence to the financial statements.

Performing Follow-Up Procedures

Auditee Responsibilities for Audit Follow-Up and for the Summary Schedule of Prior Audit Findings¹⁴

10.63 Circular A-133 states that the auditee is responsible for follow-up and corrective action on all audit findings. Part of the follow-up required by Circular A-133 is that the auditee should prepare a summary schedule of prior audit findings. (Chapter 13 of this guide discusses the summary schedule of prior audit findings.) That schedule reports the status of all audit findings included in the prior audit's schedule of findings and questioned costs relative to federal awards. It also includes audit findings reported in the prior audit's summary schedule of prior audit findings that were not identified as either (a) fully corrected, (b) no longer valid, or (c) not warranting further actions. Circular A-133 states that a valid reason for considering an audit finding as not warranting further action is that *all* of the following have occurred:

- Two years have passed since the audit report in which the finding occurred was submitted to the federal clearinghouse.
- The federal agency or pass-through entity is not currently following up with the auditee on the audit finding.
- A management decision was not issued.

10.64 Circular A-133 also states the following with regard to the auditee's schedule of prior audit findings:

- When audit findings were fully corrected, the summary schedule need only list the audit findings and state that corrective action was taken.
- When audit findings were not fully corrected or were only partially corrected, the summary schedule should describe the planned corrective action as well as any partial corrective action taken.
- When the corrective action taken is significantly different from the corrective action previously reported in a corrective action plan or in the federal agency's or pass-through entity's management decision, the summary schedule should provide an explanation.
- When the auditee believes the audit findings are no longer valid or do not warrant further actions, the reasons for this position should be described in the summary schedule, as discussed in paragraph 10.63.

Auditor Responsibilities for Follow-Up on Previously Reported Findings

10.65 Circular A-133 states that the auditor should follow up on prior audit findings, perform procedures to assess the reasonableness of the schedule of prior audit findings prepared by the auditee, and report, as a current-year audit finding, when the auditor concludes that the summary schedule of prior audit findings materially misrepresents the status of any prior audit finding. The auditor should perform audit follow-up procedures regardless of whether a

¹⁴ Chapter 2, "Planning Considerations of *Government Auditing Standards*," of this guide discusses the auditee's responsibilities under *Government Auditing Standards* for audit follow-up.

prior audit finding relates to a major program in the current year. Chapter 13 of this guide further discusses the auditor's reporting responsibilities.

Auditor Follow-Up Procedures

10.66 To follow up on previous audit findings, the auditor should obtain the auditee's summary schedule of prior audit findings and perform appropriate procedures on that information. Although in many cases the procedures performed in the current audit will provide a basis for the auditor to assess the schedule, the auditor may find it necessary to perform procedures directed specifically at the status of prior audit findings. In these cases, consideration might include the following procedures:

- Make inquiries of auditee management and program personnel, including inquiries about the status of corrective actions and the estimated completion date for incomplete actions
- Review management decisions issued by federal awarding agencies or pass-through entities to the auditee (paragraph 10.59 discusses management decisions)
- Observe an activity that has been redesigned to address a prior-year finding
- Test similar current-year transactions

Audit Follow-Up for Findings Reported Under Government Auditing Standards

10.67 As discussed in chapter 2, "Planning Considerations of *Government Auditing Standards*," of this guide, *Government Auditing Standards* establishes an additional fieldwork standard that states the auditor should evaluate whether the audited entity has taken appropriate corrective action to address findings and recommendations from previous engagements that could have a material effect on the financial statements. The auditee's schedule of prior audit findings prepared as required by Circular A-133 includes only the status of certain prior-year findings relative to federal awards. *Government Auditing Standards* does not require the auditor to report the status of prior audit findings reported under *Government Auditing Standards* in a written report. However, there may be certain financial statement audit findings that were reported in the prior period under *Government Auditing Standards* that are also included in the summary schedule of prior audit findings (because they also relate to federal awards). Although not required, some auditees may decide to include the status of other financial statement audit findings (that is, those that are not related to federal awards) in the schedule.

Corrective Action Plan

10.68 Circular A-133 also requires that upon completion of the audit, the auditee should prepare a corrective action plan that identifies the contact person responsible for corrective action and indicates the corrective action planned for each audit finding (referred to by the auditor assigned reference number) and the anticipated completion date. If the auditee does not agree with a finding, the corrective action plan should contain an explanation and specific reasons why the auditee disagrees. The auditor may find the auditee's corrective action plan useful in performing audit follow-up (in addition to the auditee's summary schedule of prior audit findings) because it may provide a preliminary indication of the corrective steps planned by the auditee. (See also the discussions in

chapters 4 and 13 concerning the *Government Auditing Standards* requirement that the auditor obtain and report the views of responsible officials concerning findings, conclusions, and recommendations, as well as planned corrective actions.)

Disputes or Unresolved Findings

10.69 There may be times when, as part of the follow-up on prior findings, the auditor determines that (a) a previous finding is the subject of a dispute between the auditee and the federal awarding agency or pass-through entity or (b) the federal awarding agency or pass-through entity has not addressed the finding by issuing a management decision. In these situations, if the finding relates to a current-year major program, this guide recommends that the auditor report similar transactions of the current year as findings and questioned costs until either the dispute is resolved or the initial finding no longer warrants further action under Circular A-133 as described in paragraph 10.63. However, if the auditor no longer believes that there is noncompliance because of additional evidence obtained in the current year, similar transactions need not be reported as findings.

Documentation Requirements

10.70 AU section 339, *Audit Documentation* (AICPA, *Professional Standards*, vol. 1), which establishes requirements and provides guidance on audit documentation, should be adapted and applied to the Circular A-133 compliance audit. Specific documentation requirements that should be adapted and applied to a Circular A-133 compliance audit may also be found in other AU sections, other standards, and supplementary audit requirements in laws and regulations applicable to the compliance audit. Paragraphs 39–42 of SAS No. 117 list specific documentation requirements related to a compliance audit. The auditor should document

- the risk assessment procedures performed, including those related to gaining an understanding of internal control over compliance.
- responses to the assessed risks of material noncompliance, the procedures performed to test compliance with the applicable compliance requirements,¹⁵ and the results of those procedures, including any tests of controls over compliance.
- materiality levels and the basis on which they were determined.
- how the auditor complied with any specific government audit requirements that are supplementary to GAAS and *Government Auditing Standards*.

Paragraph A38 of SAS No. 117 explains that the auditor is not expected to prepare specific documentation of how the auditor adapted and applied each of the applicable AU sections to the objectives of a compliance audit. The documentation of the audit strategy, audit plan, and work performed cumulatively demonstrate whether the auditor has complied with the requirements to apply and adapt AU sections to the compliance audit. (See chapter 6 for further discussion.)

¹⁵ See footnote 1.

Management Representations Related to Federal Awards

10.71 As part of a Circular A-133 compliance audit, the auditor should obtain written representations from management about matters related to federal awards. Therefore, in addition to the management representations obtained in connection with an audit of the financial statements as discussed in chapter 3 of this guide, the auditor should obtain written representations from management concerning the identification and completeness of federal award programs, representations concerning compliance with compliance requirements, and identification of known instances of noncompliance. Paragraph 10.72 contains a suggested listing of representations. Chapter 3 discusses the members of management and other officials from whom the auditor should consider obtaining representations. In a Circular A-133 audit, the auditor also should consider obtaining representations from officials responsible for managing federal awards.

Suggested Representations

10.72 SAS No. 117 states that the auditor should request from management written representations that are tailored to the entity and the governmental audit requirement. The auditor should consider obtaining the following written representations, which include those identified in SAS No. 117, as well as additional representations specific to Circular A-133:¹⁶

- Management is responsible for complying, and has complied, with the requirements of Circular A-133.
- Management is responsible for understanding and complying with the requirements of laws, regulations, and the provisions of contracts and grant agreements related to each of its federal programs.¹⁷
- Management is responsible for establishing and maintaining, and has established and maintained, effective internal control over compliance for federal programs that provides reasonable assurance that the auditee is managing federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on its federal programs.¹⁸
- Management has prepared the schedule of expenditures of federal awards in accordance with Circular A-133 and has included expenditures made during the period being audited for all awards provided by federal agencies in the form of grants, federal cost-reimbursement contracts, loans, loan guarantees, property (including donated surplus property), cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, and other assistance.

¹⁶ The auditor should modify these representations, as appropriate, for different conditions, such as known noncompliance.

¹⁷ SAS No. 117 notes that, in some cases, management may include qualifying language in the written representation to the effect that representations are made to the best of management's knowledge and belief. However, SAS No. 117 notes that qualifying language is not appropriate for this representation.

¹⁸ See footnote 17.

- Management has identified and disclosed to the auditor the requirements of laws, regulations, and the provisions of contracts and grant agreements that are considered to have a direct and material effect on each major program.
- Management has made available all contracts and grant agreements (including amendments, if any) and any other correspondence relevant to federal programs and related activities that have taken place with federal agencies or pass-through entities.
- Management has identified and disclosed to the auditor all amounts questioned and all known noncompliance with the direct and material compliance requirements of federal awards.
- Management believes that the auditee has complied with the direct and material compliance requirements (except for noncompliance it has disclosed to the auditor).
- Management has made available all documentation related to compliance with the direct and material compliance requirements, including information related to federal program financial reports and claims for advances and reimbursements.
- Management has provided to the auditor its interpretations of any compliance requirements that are subject to varying interpretations.
- Management has disclosed to the auditor any communications from grantors and pass-through entities concerning possible noncompliance with the direct and material compliance requirements, including communications received from the end of the period covered by the compliance audit to the date of the auditor's report.
- Management has disclosed to the auditor the findings received and related corrective actions taken for previous audits, attestation engagements, and internal or external monitoring that directly relate to the objectives of the compliance audit, including findings received and corrective actions taken from the end of the period covered by the compliance audit to the date of the auditor's report.
- Management is responsible for taking corrective action on audit findings of the compliance audit.¹⁹
- Management has provided the auditor with all information on the status of the follow-up on prior audit findings by federal awarding agencies and pass-through entities, including all management decisions.
- Management has disclosed the nature of any subsequent events that provide additional evidence with respect to conditions that existed at the end of the reporting period that affect noncompliance during the reporting period.
- Management has disclosed all known noncompliance with direct and material compliance requirements occurring subsequent to the period covered by the auditor's report or stating that there were no such known instances.

¹⁹ See footnote 17.

- Management has disclosed whether any changes in internal control over compliance or other factors that might significantly affect internal control, including any corrective action taken by management with regard to significant deficiencies in internal control over compliance (including material weaknesses in internal control over compliance), have occurred subsequent to the date as of which compliance is audited.
- Federal program financial reports and claims for advances and reimbursements are supported by the books and records from which the basic financial statements have been prepared.
- The copies of federal program financial reports provided to the auditor are true copies of the reports submitted, or electronically transmitted, to the federal agency or pass-through entity, as applicable.
- If applicable, management has monitored subrecipients to determine that they have expended pass-through assistance in accordance with applicable laws and regulations and have met the requirements of Circular A-133.
- If applicable, management has issued management decisions timely after their receipt of subrecipients' auditor's reports that identified noncompliance with laws, regulations, or the provisions of contracts or grant agreements, and has ensured that subrecipients have taken the appropriate and timely corrective action on findings.
- If applicable, management has considered the results of subrecipient audits and has made any necessary adjustments to the auditee's own books and records.
- Management has charged costs to federal awards in accordance with applicable cost principles.
- Management is responsible for, and has accurately prepared, the summary schedule of prior audit findings to include all findings required to be included by Circular A-133.
- Management has accurately completed the appropriate sections of the data collection form.
- If applicable, management has disclosed all contracts or other agreements with service organizations.
- If applicable, management has disclosed to the auditor all communications from service organizations relating to noncompliance at those organizations.

The auditor may determine that additional representations related to the entity's compliance with the direct and material compliance requirements are necessary. If so, the auditor should request such additional representations.

Refusal to Furnish Written Representations

10.73 Management's refusal to furnish all written representations that the auditor considers necessary in the circumstances constitutes a limitation on the scope of the audit sufficient to require a qualified opinion or disclaimer of opinion on the auditee's compliance with major program requirements. The auditor also should consider the effects of management's refusal on his or her ability to rely on other management representations.

State and Local Government Compliance Auditing Considerations

10.74 An auditor also may be engaged to test and report on compliance with state and local laws and regulations in addition to the testing and reporting requirements imposed by *Government Auditing Standards* and Circular A-133. Although such auditing is outside the scope of this guide, such a requirement may specify compliance tests, similar to those in a single audit. When this is the case, auditors might consider consulting state or local government officials or other sources concerning the nature and scope of the required testing. It is important to distinguish state or local government funds from pass-through federal funds because pass-through federal funds are considered part of the federal awards received in an audit in accordance with Circular A-133.

American Recovery and Reinvestment Act Considerations*

10.75 Funds awarded under the Recovery Act will significantly affect a compliance audit. The transparency and accountability provisions of the act subject Recovery Act awards to additional compliance requirements, and those requirements may vary for each award received. Because guidance from the OMB is being issued on an ongoing basis, it is important that recipients of Recovery Act awards, and their auditors, monitor the guidance being issued.

* Information in this guide related to the American Recovery and Reinvestment Act of 2009 (Recovery Act) is based upon the latest information available at the time of this writing. However, this information is subject to change because guidance from the OMB is being issued and updated on an ongoing basis. It is important for recipients of Recovery Act funding, and their auditors, to monitor the guidance issued. For the latest OMB guidance, go to the OMB website at www.whitehouse.gov/omb/recovery/default. Information can also be found at the Recovery Act Resource Center on the Governmental Audit Quality Center website, which is open to the public at www.aicpa.org/INTERESTAREAS/GOVERNMENTALAUDITQUALITY/RESOURCES/RECOVERYACTRESOURCECENTER/Pages/default.aspx and at the U.S. Government's official Recovery Act website at www.recovery.gov.

Chapter 11

Audit Sampling Considerations of Circular A-133 Compliance Audits

Note: The audit required by the Single Audit Act Amendments of 1996 and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133), is performed in accordance with *Government Auditing Standards*. Part I, "Government Auditing Standards Audits," (chapters 2–4 of this guide), discusses financial statement audits under generally accepted auditing standards and *Government Auditing Standards*. The guidance in parts I and II, "Circular A-133 Audits," (chapters 5–14 of this guide) is applicable for those auditors performing an audit under the Single Audit Act Amendments of 1996 and Circular A-133.

Information related to the American Recovery and Reinvestment Act of 2009 (Recovery Act) can be found in a section located at the end of each chapter in part II of this guide. See the section titled "American Recovery and Reinvestment Act Considerations" beginning at paragraph 11.136 in this chapter. See also the preface section titled "Impact of the American Recovery and Reinvestment Act of 2009 on Single Audits."

Introduction

11.01 An auditor may decide to use audit sampling to obtain sufficient appropriate audit evidence in a compliance audit, as noted in paragraph A21 of Statement on Auditing Standards (SAS) No. 117, *Compliance Audits* (AICPA, *Professional Standards*, vol. 1, AU sec. 801). AU section 350, *Audit Sampling*¹ (AICPA, *Professional Standards*, vol. 1), provides guidance for planning, performing, and evaluating audit samples. It includes guidance related to sampling risk, sampling in substantive tests of details, sampling in tests of controls, and includes a discussion of dual purpose samples. The guidance in AU section 350 primarily addresses sampling considerations when performing a financial statement audit, with an emphasis on testing account balances or classes of transactions that may contain misstatements as well as testing internal control over financial reporting. Sampling to accomplish compliance-related audit objectives in a Circular A-133 compliance audit environment differs from sampling in a financial statement audit in that to meet the compliance-related

¹ AICPA Audit Guide *Audit Sampling* is an interpretive publication, which assists practitioners in the application of the guidance found in AU section 350, *Audit Sampling* (AICPA, *Professional Standards*, vol. 1). Interpretive publications are recommendations on the application of auditing standards in specific circumstances and are issued under the authority of the Auditing Standards Board. An auditor should be aware of and consider interpretive publications applicable to his or her audit. If the auditor does not apply the auditing guidance included in an applicable interpretive publication, the auditor should be prepared to explain how he or she complied with the Statements on Auditing Standards (SASs) provisions addressed by such auditing guidance. The Audit Guide *Audit Sampling* is available at www.cpa2biz.com.

objectives, the auditor gathers sufficient appropriate audit evidence on whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on each major program.

11.02 This chapter provides considerations in designing an audit approach that includes audit sampling to achieve both compliance and internal control over compliance related audit objectives in a Circular A-133 compliance audit or program-specific audit performed in accordance with Circular A-133. This chapter builds upon the general guidance set forth in AU section 350, (as discussed in the AICPA Audit Guide *Audit Sampling*) by providing specific, relevant sampling guidance for a Circular A-133 compliance audit or program-specific audit.

11.03 In addition to providing important considerations when applying sampling in a Circular A-133 compliance audit, this chapter provides suggested minimum sample sizes for tests of controls over compliance and tests of compliance based on certain engagement-specific inputs. Depending on the nature of the type of compliance requirement being tested, the results of other audit procedures performed during the audit, and the risks and complexities of the sampling population, there may be situations where auditors may determine, based on professional judgment, that it is appropriate to use larger sample sizes rather than the suggested minimum sample sizes.

11.04 This chapter does not include guidance on every possible valid method of selecting and evaluating audit samples in a Circular A-133 compliance audit. The AICPA Audit Guide *Audit Sampling* provides additional guidance and technical background, which forms the basis of the practical application of audit sampling to Circular A-133 compliance audits as outlined in this chapter.

Audit Sampling in a Circular A-133 Compliance Audit

11.05 Paragraph .01 of AU section 350 defines *audit sampling* as the application of an audit procedure to less than 100 percent of the items within an account balance or class of transactions for the purpose of evaluating some characteristic of the balance or class. In other words, audit sampling may provide the auditor an appropriate basis on which to conclude on a characteristic of a population based on examining evidence regarding that characteristic from a subset of the population. When using audit sampling, the auditor may choose between a statistical and a nonstatistical approach. Both methods are acceptable under AU section 350.

Purpose and Nature of Audit Sampling in a Circular A-133 Compliance Audit

11.06 The auditor's objectives in a Circular A-133 compliance audit include reporting on internal control over compliance as discussed in chapter 9, "Consideration of Internal Control Over Compliance for Major Programs," of this guide and whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements pertaining to federal awards that may have a direct and material effect on each of its major programs as discussed in chapter 10, "Compliance Auditing Applicable to Major Programs," of this guide. The auditor should obtain sufficient appropriate audit evidence to support the opinion on compliance for each major program, as well as to meet the requirements of Circular A-133 for testing and reporting on internal

control over compliance. Such evidence may be obtained through a variety of procedures, including planning and performing risk assessment procedures, performing tests of controls, performing tests of details (including tests of transactions), and other auditing procedures as are necessary. Auditors frequently use audit sampling procedures to obtain such audit evidence.

11.07 When testing internal control over compliance, the auditor is primarily concerned about the rates of deviations from a prescribed control. Similarly, in tests of compliance, the auditor is concerned about whether or not there is evidence of compliance (that is the rate and likely magnitude of noncompliance). Therefore, *attribute sampling*, as defined in the AICPA Audit Guide *Audit Sampling*, is typically used for tests of controls over compliance and compliance testing in a Circular A-133 compliance audit. The underlying basis for the large population sample sizes provided in this chapter is attribute sampling.

11.08 Further, as noted in chapter 10 of this guide, Circular A-133 states that the auditor should report known questioned costs when likely questioned costs² for a type of compliance requirement for a major program are greater than \$10,000. That is, the auditor should report known questioned costs but is not required to report the likely questioned costs. In evaluating the effect of questioned costs (found through sampling and other audit procedures) on the opinion on compliance, the auditor should consider the best estimate of the total costs questioned for each major program (likely questioned costs), not just the questioned costs specifically identified (known questioned costs).

11.09 When noncompliance is discovered related to monetary transactions of a major program, Circular A-133 does not require the auditor to report an exact amount or a statistical projection of likely questioned costs with related confidence bounds. Instead, as noted previously and further discussed in chapter 10 of this guide, the auditor should consider the effect of likely questioned costs on the opinion on compliance and should report an audit finding when the auditor's estimate of likely questioned costs is greater than \$10,000.

Audit Sampling in the Context of Other Audit Procedures

11.10 It is important to note that sampling is one of many audit procedures designed to provide sufficient appropriate audit evidence to support the auditor's compliance opinion on each major program. An auditor often does not rely solely on the results of any single type of procedure to obtain sufficient appropriate audit evidence on each major program's compliance and internal control over compliance. Rather, audit conclusions may be based on evidence obtained from several sources and by applying a variety of audit procedures. Auditors should consider the combined evidence obtained from the various types of procedures to determine whether there is sufficient appropriate audit evidence to evaluate possible audit findings and to develop the auditor's report on internal control over compliance and the opinion on whether the auditee complied with laws, regulations, and the provisions of contracts or grants for each major program.

² Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133), defines *likely questioned costs* as the auditor's best estimate of total costs questioned. *Known questioned costs* are questioned costs specifically identified by the auditor and a subset of likely questioned costs. As noted in the glossary of SAS No. 117, *Compliance Audits* (AICPA, *Professional Standards*, vol. 1, AU sec. 801), *likely questioned costs* are developed by extrapolating from audit evidence obtained, for example, by projecting known questioned costs identified in an audit sample to the entire population from which the sample was drawn.

11.11 In a Circular A-133 compliance audit, just as in a financial statement audit, other audit procedures beyond sampling are performed. For instance, risk assessment procedures typically precede tests of controls. The following are specific examples of other audit procedures used in a Circular A-133 compliance audit that may be used in addition to audit sampling:

- Determining for each major program the direct and material types of compliance requirements to be tested and reported on in a Circular A-133 compliance audit (see chapter 10 of this guide for further discussion)
- Using the knowledge gained in the inherent risk of noncompliance assessment process (as described in chapter 6, "Planning Considerations of Circular A-133," of this guide) to identify types of potential noncompliance, to consider other factors that affect the risk of material noncompliance, and to design appropriate tests of compliance
- Performing analytical procedures to further understand the nature of a major program prior to performing compliance testing
- Identifying risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks of noncompliance, evaluating the design of controls relevant to the compliance audit, and determining whether they have been implemented
- Considering whether there are individually important items that may merit being specifically tested prior to selecting a sample (see paragraphs 11.21–.28)

Procedures That May Not Involve Audit Sampling

11.12 The following paragraphs discuss compliance and internal control over compliance audit procedures that generally do not involve audit sampling.

Inquiry and Observation

11.13 Inquiry, as discussed in paragraphs .31–.36 of AU section 326, *Audit Evidence* (AICPA, *Professional Standards*, vol. 1), consists of seeking information of knowledgeable persons, both financial and nonfinancial, inside or outside the entity. Observation, as discussed in paragraph .30 of AU section 326 consists of looking at a process or procedure being performed by others. Inquiry and observation procedures commonly used in a Circular A-133 compliance audit include the following:

- Interviewing management and employees to obtain an understanding of internal control over compliance
- Observing the behavior of personnel and the functioning of business operations
- Observing cash handling activities
- Performing walkthrough procedures³

³ Walkthroughs may include an examination of evidence and reperformance, depending on their design and performance.

- Observing the existence of real property and equipment
- Obtaining written representations from management

In some cases, these procedures could be designed as sampling procedures, such as designing multiple observations of physical security controls; however, inquiry and observation generally do not involve audit sampling.

Analytical Procedures

11.14 Analytical procedures, as discussed in AU section 329, *Analytical Procedures* (AICPA, *Professional Standards*, vol. 1), consist of evaluations of information made by a study of plausible relationships among both financial and nonfinancial data. These procedures are not considered audit sampling because they do not result in the ability to project the results of testing a portion of the population to the total population.

11.15 As noted in paragraph A23 of SAS No. 117, the use of analytical procedures to gather substantive evidence is generally less effective in a compliance audit than it is in a financial statement audit. However, substantive analytical procedures may contribute some evidence when performed in addition to tests of transactions and other auditing procedures necessary to provide the auditor with sufficient appropriate audit evidence.

11.16 An example of applying analytical procedures in a Circular A-133 compliance audit may include a test relating to the Activities Allowed or Unallowed type of compliance requirement for a school lunch program. An auditor may use analytical procedures to calculate an estimated total for nutritional expenditures and compare against actual expenditures to provide some audit evidence that could reduce compliance tests assuming the auditor is confident with the completeness and accuracy of the underlying data. Calculating estimated participation could be accomplished by multiplying the number of students enrolled in a school system by the percentage expected to participate in a school nutrition program. This percentage may be based on history, current economic trends and statistics in the area, or other factors. The calculated estimation then could be multiplied by an average daily cost of the nutrition program per student to estimate the total expenditures for the program. The auditor may then compare the estimation to the recorded expenditures to determine if there is a difference material to the program being tested.

11.17 Scanning is another common nonsampling analytical procedure. The following provide two examples of how scanning might be used in a Circular A-133 compliance audit:

- a. For a school district Circular A-133 compliance audit, auditors could scan a list of employees that charged time to a grant to determine that the type of employee and school appear reasonable (for example, when scanning a list of employees charged to vocational education programs, the auditor normally would not expect to see an elementary school teacher included).
- b. For a social services grant or education training program that, by its nature, would not include equipment purchases, auditors could scan a list of program expenditures for captions that indicate a disbursement was made for equipment.

Procedures Applied to Every Item in a Population or Subpopulation in Compliance Testing

11.18 In some circumstances, an auditor might decide to examine every item in a population relating to a type of compliance requirement for a major program. In this situation, because the auditor is examining the entire population to reach a conclusion, rather than only a portion, this 100 percent examination is not a procedure that involves audit sampling.

11.19 When individually important items (see paragraphs 11.21–.28) do not make up the entire population, after testing all individually important items, the auditor might apply audit sampling to the remaining items (see paragraphs 11.21–.28 for an additional discussion of individually important items).

11.20 Alternatively, after testing all individually important items, an auditor might either (a) apply other auditing procedures to the remaining items in the population (for example, scanning), or (b) apply no auditing procedures to remaining items because there is an acceptably low risk of material noncompliance in the remaining items. In these 2 scenarios, the auditor is not using sampling. Rather, the auditor has divided the entire population of items into 2 groups. One subpopulation is tested 100 percent, and the other subpopulation is either tested by other auditing procedures or is not tested.

Individually Important Items in Compliance Testing⁴

11.21 When planning compliance testing for each major program, the auditor may use judgment to determine what items, if any, represent individually important items that may be individually tested and separated from the remaining population. Items of individual importance may be large, risky, or unusual items or transactions that contain characteristics of a prior compliance finding. Individually important items are those that, standing alone, are significantly different from the remainder of the population, for example, spikes in activity around a certain time period, such as journal entries made at the beginning or the close of a grant (see paragraph 11.27 for additional examples).

11.22 Although the identification of individually important items is not required by Circular A-133, there are benefits to taking advantage of testing individually important transactions if they exist in a particular population. Specifically, the application of auditor judgment and experience in examining a population for risky or unusual transactions may be more effective at identifying noncompliance than a randomly or haphazardly selected sample (see paragraphs 11.94–.96 for further discussion of random and haphazard sample selection). Furthermore, testing individually important items may reduce detection risk of noncompliance in that the individually important items that the auditor decides to test are not part of the population subject to audit sampling. As such, testing individually important items may reduce the sample size for the items remaining in the sampling population, or it may eliminate having to sample altogether because it targets those items that have the largest effect on noncompliance. For example, if 80 percent of the total grant expenditures can

⁴ AICPA Audit Guide *Audit Sampling* uses the term *individually significant*, whereas this guide uses *individually important*. Note that in the context of individually important, there is no requirement for auditors to consider or test, or both, such items.

be examined by testing the largest 10 expenditures, detection risk of noncompliance may be reduced such that the level of assurance needed from a sample of the remaining 20 percent of untested items will be lower.

11.23 It is important to note that the concept of identifying individually important items and focusing testing on a limited number of large or unusual items relate to compliance testing and not to testing internal control over compliance.

11.24 It is also important to clarify that a large number of transactions making up a significant percentage of the dollars expended or having a significant effect on compliance typically would not represent individually important items because individually important items are usually represented by only a relatively small number of items.

11.25 Identifying individually important items may involve discussions with auditees, analytical procedures such as scanning records (as described in paragraph 11.17), or using computer assisted auditing techniques. For example, in testing the Allowable Costs/Cost Principles type of compliance requirement, if there are a few very large expenditures, the auditor may deem these expenditures to be individually important.

11.26 Identifying individually important items may not be an efficient method when testing multiple types of compliance requirements at once because an individually important item with respect to a particular type of compliance requirement may not necessarily be an individually important item for another type of compliance requirement. For example, it would not likely be appropriate to identify a few individually important items to test the Activities Allowed or Unallowed type of compliance requirement, and then use the testing of those few items to support the auditor's conclusions relating to certain other direct and material compliance requirements.⁵ It is likely that supplemental tests may be necessary to gather sufficient appropriate audit evidence related to compliance with other direct and material compliance requirements.

11.27 Additional examples of individually important items (and the relevant type of compliance requirement) might include the following:

- Transactions processed at the beginning or end of a grant award period (Activities Allowed or Unallowed, Period of Availability of Federal Funds).
- Transactions processed at odd times in a cycle, such as new beneficiaries brought into a program in the spring when eligibility is usually granted only once a year during an enrollment period in the fall (Eligibility).
- Program beneficiaries that are near a qualifying age for benefits, or beneficiaries who have received multiple sources of funds (Eligibility).

⁵ SAS No. 117 defines *applicable compliance requirements* as the compliance requirements that are subject to the compliance audit. Paragraph .500(d) of Circular A-133 states that the auditor should determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that may have a direct and material effect on each of its major programs. Therefore, in a Circular A-133 compliance audit, the direct and material compliance requirements are those that are subject to audit. Accordingly, for the purpose of adapting SAS No. 117 to a Circular A-133 compliance audit, the term *applicable compliance requirements* has been replaced by *direct and material compliance requirements* in this guide except when directly citing content from SAS No. 117.

- A grant close-out report, as compared to routine financial or progress reports (Reporting).
- Transactions related to subrecipients that are awarded unusually high dollar amounts of pass-through funds compared with prior periods or other subrecipients in the same program (Subrecipient Monitoring).
- Transactions related to subrecipients that are new to the grantee, especially newly formed entities that have a relatively immature infrastructure to support compliance (Subrecipient Monitoring).
- Transactions processed in foreign countries that may contain higher risks such as foreign currency risk or different payroll and human resources issues and laws in other countries that may affect allowable costs (Activities Allowed or Unallowed, Subrecipient Monitoring).
- Transactions that tests of internal control over compliance have indicated are either not subject to controls or are not being processed appropriately (multiple types of compliance requirements).
- A type of transaction for which there have been findings in the past. For example, one large construction contract has not complied with Davis-Bacon in the past, but there have not been issues for other contracts (multiple types of compliance requirements).
- Transactions related to a specific step within the *OMB Circular A-133 Compliance Supplement (Compliance Supplement)*. For example, large transfers of funds from program accounts which may have been used to fund unallowable activities (Activities Allowed or Unallowed).

11.28 The auditor should prepare appropriate documentation to support a clear understanding of the work performed on individually important items, which may include the rationale, selection criteria, results of testing, and effect on the planned testing of the remainder of the population.

Understanding and Testing the Operating Effectiveness of Controls Over Compliance

11.29 There are a variety of methods the auditor may use when performing risk assessment procedures, including inquiry, observation, inspection of documentary evidence, walkthrough, and reperformance of a process, that affect the auditor's understanding and testing of the operating effectiveness of controls. Although many procedures where documentary evidence is examined or where the auditor reperforms a control involve audit sampling, certain other methods may not involve sampling (for example, inspecting one or a few items to obtain an understanding of controls). Also, paragraph .32 of AU section 350 specifies certain types of tests of controls that, because of the nature of the procedures, do not normally involve audit sampling. For example, tests of automated application controls may be tested only once or a few times when effective information technology general controls are present. In this situation, the auditor would not be using audit sampling.

11.30 Similarly, when testing internal control over compliance, the auditor does not use audit sampling when he or she applies an auditing procedure to one or a number of items relating to a control over a type of compliance requirement for purposes *other* than evaluating a trait of the entire population.

For example, an auditor might trace several grant expenditure transactions through an auditee's accounting system to obtain an understanding of the design of the auditee's internal control over compliance with respect to the grant expenditures, such as approvals of the expenditures as an allowable activity, an allowable cost, or within the period of availability. In such cases, the auditor's intent is to gain a general understanding of the accounting system or other relevant parts of the internal control over compliance, rather than to evaluate a characteristic of all transactions processed. As a result, the auditor is not using audit sampling.

Planning Considerations for Sampling Related to Tests of Controls Over Compliance and Compliance Testing

Determining Audit Objectives

11.31 Paragraph 11.06 describes the audit objectives in a Circular A-133 compliance audit. Proper definition and documentation of the audit objective precedes sampling design and execution. When designing a particular sample, the auditor should consider the specific audit objective to be achieved (for example, a necessary control was performed effectively or an expenditure was charged to a grant allowable under the appropriate OMB Cost Circular) and should determine that the audit procedure, or combination of procedures, to be applied will achieve that objective.

11.32 The specific compliance audit objectives will differ for each type of compliance requirement. Part 3 of the *Compliance Supplement* lists and describes the 14 types of compliance requirements and the related audit objectives that the auditor should consider in Circular A-133 compliance audits.⁶ Part 6 of the *Compliance Supplement* provides the auditor with guidance and a general discussion of the control objectives, components, and activities that are likely to apply to the 14 types of compliance requirements. Chapters 9–10 of this guide discuss the concepts involved in properly planning the testing of compliance and internal control over compliance.

Defining the Population and Considering Completeness

11.33 The population is defined in a manner consistent with the audit objective and the internal control and compliance attributes being tested. The auditor should determine that the sampling unit and the population from which units are selected for sampling is appropriate for the specific audit objective because sample results can be appropriately projected only to the population from which the sample was selected. For example, consider a situation where the auditor plans to test timesheets for proper authorization (that is, testing an internal control over Activities Allowed or Unallowed type of compliance requirement) for a major program that involves multiple departments within an auditee. In defining the population, the auditor may first gain an understanding of how frequently timesheets are prepared and reviewed. Further, the auditor may also determine if the timesheets in the various departments within the auditee constitute one population or separate populations by considering

⁶ Chapter 14, "Program-Specific Audits," of this guide discusses program-specific audits and the use of federal program specific audit guides and other methods for determining compliance requirements and related audit objectives in a program-specific audit.

whether the systems and controls for approval differ among the departments (for example, whether all supervisors approving timesheets attend a uniform training session), or other factors that would affect the definition of the control. There are also situations where a time period may define a sampling population (for example, for the Period of Availability of Federal Funds type of compliance requirement, the *Compliance Supplement* defines certain time periods as a sampling population).

11.34 The sampling population includes the items constituting the transactions of interest for an audit objective related to a particular control or a type of compliance requirement after removing transactions tested with non-sampling techniques (for example, individually important items or a subset of items that are tested 100 percent). It is possible that the appropriate sampling population may only be a subset of the universe of transactions subject to a particular control or compliance requirement. For example, the universe of transactions within an expenditure pool may be defined by the auditor as multiple populations when transaction processing and the operation of related controls are decentralized.

11.35 The types of expenditures related to an audit objective are also an important factor in determining whether further division of the population may be necessary to achieve the stated objective. For example, the controls over the Allowable Costs/Cost Principles type of compliance requirement may vary depending on whether the expenditure is a direct (other than payroll), indirect, or payroll expenditure.

11.36 An auditee might change a specific control or compliance procedure during the period under audit. The auditor should obtain audit evidence about the nature and extent of any significant changes in internal control and may need to revise the audit plan. Chapter 3, "Nonstatistical and Statistical Audit Sampling in Test of Controls," of the AICPA Audit Guide *Audit Sampling* discusses additional considerations when there are changes in processes and procedures during the period under audit as well as important sampling considerations if testing is conducted at an interim date.

11.37 The auditor should select a sample in such a way that the sample can be expected to be representative of the population. If the physical representation (for example, a printout or electronic file purportedly containing all expenditures) and the desired population differ, the auditor might make erroneous conclusions about the population. To verify the completeness of a population, the auditor could, for example, reconcile the population to accounting or other relevant records or to the schedule of expenditures of federal awards, or perform other procedures to verify the population is complete. Populations relevant for a Circular A-133 compliance audit testing may not consist of accounting records (for example, eligibility files for a particular major program do not directly relate to a financial statement amount). Regardless, the auditor should develop and perform audit procedures sufficient to conclude that the population includes all the transactions of interest for the specific audit objective.

11.38 If an initial sample does not include a particular attribute being tested, it may be an indication that the sampling population was not defined properly. For example, an initial sample may have been selected from a schedule of financial aid that did not include a listing of students who were enrolled part-time or students enrolled in correspondence study. However, to meet the audit

objective, the auditor would need to include such students in the testing. The auditor may consider maintaining the original sample and adding a selection of students who were enrolled part-time or students enrolled in correspondence study to the sample. The number of additional items to be added is a matter of professional judgment. In the previous example, the auditor may consider consistency of student financial aid processing controls, number of students who were enrolled part-time or enrolled in correspondence study, and other considerations from the risk assessment process to determine whether to reevaluate the original population or add items with the needed attribute.

Sampling Unit

11.39 The sampling unit may be defined by any of the individual elements constituting the population. Each sampling unit constitutes one item in the population. In a Circular A-133 compliance audit, a sampling unit might be a cash disbursement, student file, refund paid, financial report due during a fiscal year, or a cost transfer made during the year.

11.40 The definition of the sampling unit depends on the audit objective and the nature of the audit procedures being applied. For example, a sampling unit for a test of controls related to the Activities Allowed or Unallowed type of compliance requirement may be a payment voucher, a journal entry, or another document that includes evidence of approval or review of the allowability of the expenditure. Note that each sampling unit may provide evidence of the application of more than one control. For example, a voucher package may provide support that the amounts were checked for accuracy, the vendor was checked for suspension and debarment, that the expenditure was for an allowable activity under the grant agreement and for an allowable cost under the relevant OMB Cost Circular, and that the expenditure was incurred and obligated within the period of availability of the grant period.

11.41 In order to properly define the sampling unit, it is also important that the auditor determine how the auditee maintains its records (for example, by participant, by program, by location). Based on the nature of the records, the auditor may then properly design a method to define the sampling unit and identify the sampling population.

Considering Multiple Major Programs

11.42 It is very common for auditees to have multiple major programs. Auditees may use the same controls for a particular type of compliance requirement (for example, Allowable Costs/Cost Principles) for more than 1 federal program. If the auditee's internal control for a type of compliance requirement is common to more than 1 major program, the transactions of those programs may be combined into 1 population for determining sample size and for making sample selections for internal control tests. If the initial sample (taken from a combined population) does not include items from each major program, the auditor typically will judgmentally add additional items from the program(s) not represented.⁷ Alternatively, the auditor may plan the initial combined sample to draw items from each major program. For example, consider a situation where an auditee has common internal controls over the Allowable Costs/Cost Principles type of compliance requirement relating to 3 major programs. If in

⁷ If an initial sample does not include a major program, it could also indicate that the physical representation (for example, a printout or electronic file purportedly containing all expenditures) of the population used to draw the sample was incomplete, see paragraphs 11.33–.38.

this example, the auditor decides to use a combined sample of 60 items and the programs are of similar size, the auditor may select 20 items from each of the 3 major programs. If the major programs are not of similar size, the sample may be allocated proportionately. In considering whether samples selected from across multiple programs can be designed for dual purposes, please see paragraph 11.43 as well as a discussion of dual purpose testing at paragraphs 11.52–57.

11.43 The auditor is required to obtain sufficient appropriate audit evidence to support an opinion on compliance for each major federal program. Experience has shown that it is preferable to select separate samples for compliance testing from each major program because the separate samples provide clear evidence of the compliance tests performed, the results of those tests, and the conclusions reached. Thus, unlike tests of controls over compliance, compliance testing is typically performed on samples selected with each major program considered a separate population. If an auditor believes a compliance sample can be selected from a population consisting of multiple major programs, an important aspect of the documentation includes how the results relate to separate programs and how that evidence, together with other audit evidence, is sufficient to support the opinion on each major program's compliance.

Considering Multiple-Components

11.44 Auditors may have additional sampling considerations when the auditee has operations in multiple-components (for example, organizational units, locations, or branches). Each component may maintain separate internal control over compliance that is relevant to the programs, or parts of programs, which the component administers. In these situations, the auditor should consider the understanding of internal control over compliance to determine whether to define each component as a separate population (chapter 9 of this guide discusses internal control over compliance in multiple-components). For a discussion of multiple-component considerations related to compliance, please refer to chapter 10 of this guide.

11.45 If controls over compliance or compliance procedures at the various components vary significantly, it may be necessary for each location to be considered a separate population. When transactions relating to types of compliance requirements are processed in multiple components using the same controls,⁸ or compliance procedures under common oversight and monitoring, it may be feasible for the auditor to obtain sufficient appropriate audit evidence about controls and compliance for major programs by selecting one overall sample across the multiple components (for example, selecting from centralized locations or visiting all components). When it is not feasible to obtain the evidence centrally or to visit all the components, and controls or compliance procedures, or both, are the same across components, the auditor generally will select some components from which to obtain audit evidence. In this case, the auditor may consider (a) testing the minimum sample size at each location of significance (or more than the minimum sample size depending on the results of risk assessment procedures preceding sampling), or (b) varying the selection of the less significant components included in the testing from year to year. Appendix E,

⁸ When evaluating whether multiple components use the same controls, *same* does not mean *identical*. The auditor may consider the important elements of the control such as the control activity, related monitoring, as well as the differences in experience and training of the individuals processing or monitoring the compliance transaction when determining if there are significant variances.

"Multilocation Sampling Considerations," of the AICPA Audit Guide *Audit Sampling* provides useful guidance in determining the appropriate components to visit, as well as implications on sample size.

Considering Clusters of Programs

11.46 The audit opinion on a cluster of programs is for the cluster as a whole and not each individual Code of Federal Domestic Assistance (CFDA) number, grant, award, and so forth that makes up the cluster. Chapter 5, "Overview of the Single Audit Act, Circular A-133, and the *Compliance Supplement*," of this guide further discusses clusters of programs. When sampling involves a cluster of programs, the auditor should consider whether, in the auditor's judgment, sufficient appropriate audit evidence has been gathered for the direct and material types of compliance requirements relating to the clustered programs as a whole. Random or haphazard selection (further discussed in paragraphs 11.94–.96) of sample items from the cluster generally would be expected to provide a representative sample.

11.47 There may be instances where the initial sample does not appear to be representative because it does not include items relating to certain direct and material types of compliance requirements for CFDA numbers, grants, awards, and so forth within the cluster. In this case, the auditor's determination of what additional evidence is needed requires professional judgment. Factors that may be considered by the auditor in determining whether to supplement the original sample include: the consistency of processing controls over the various programs within the cluster, the volume of transactions and the size of expenditures for a particular program as a component of the overall cluster being tested, the complexity of the compliance requirements, and the past history of compliance. As with other forms of audit testing, the auditor should document the objective of the cluster testing and the sample design.

11.48 An alternative approach to selecting sample items in a cluster, if auditee records permit, may be for the auditor to analyze the components of the cluster transactions (for example, expenses) and grants prior to selecting the sample and then to allocate the number of selections from the sample to the transactions or programs in proportion to the overall cluster. This alternative may be difficult to execute depending on how the auditee keeps their records.

Considering the Effect of Population Size

11.49 The size of the population has little or no effect on the determination of sample size, except in relatively small populations of 250 items or fewer. Some significant controls or compliance procedures the auditor may be testing sometimes operate infrequently. For example, controls over reporting may operate only 4, 12, 24, or 52 times a year. Paragraphs 11.86–.89 provide sample sizes for small populations.

Defining Control Deviation and Compliance Exception Conditions⁹

11.50 Based on the auditor's understanding of internal control over compliance and compliance requirements, an auditor generally will identify the characteristics that would indicate performance of the control or compliance requirement to be tested. The auditor may then define the possible deviation

⁹ In this chapter, the term *deviation* is associated with controls testing, and the term *exception* is associated with compliance testing.

or exception conditions. For tests of controls, a deviation is a departure from the expected performance of the prescribed control. For compliance testing, an exception is a departure from laws, regulations, and the provisions of contracts or grant agreements being tested. Defining a deviation or exception for each audit objective assists the auditor executing the procedures to properly identify deficiencies in internal control over compliance and instances of noncompliance.

11.51 In a Circular A-133 compliance audit, the auditor should consider the nature and cause of the internal control deviations and compliance exceptions identified in testing. The auditor should determine whether the deviation(s) or exception(s) constitutes a finding and whether the sampling evidence, in combination with other testing, might affect the auditor's opinion on compliance.

Dual Purpose Samples Considerations

11.52 In some circumstances, the auditor might design a test that uses a *dual purpose* sample. The most common dual purpose approach in a Circular A-133 compliance audit is testing the operating effectiveness of a control and testing whether the auditee complied with relevant laws, regulations, or provisions of contracts or grant agreements using the same sample. For example, subrecipient monitoring often can be tested with a dual purpose sample. If the sampling unit is a subrecipient reimbursement request, the documentation may contain evidence of review by the pass-through (for example, signature) and compliance with monitoring activities. When utilizing a dual purpose sample for internal control and compliance testing, it is important that the test objectives align to the same sampling unit and population (that is, the population being sampled is appropriate for the tests being applied to it). As stated in paragraph 11.33, an auditor should determine that the population from which the sample is selected is appropriate for the specific audit objectives being executed. The size of a sample designed for dual purposes should be the larger of the samples that would otherwise have been designed if the control and compliance samples were performed separately.

11.53 When testing both the operating effectiveness of a control and whether the auditee complied with a type of compliance requirement, the basis for the auditor's evaluation of the control is the operation of the control and not just whether the auditee complied. Further, a control that is not properly applied to a transaction may not necessarily lead to noncompliance. As such, the auditor may reach different conclusions on controls and compliance for the same sample item (for example, report a significant deficiency or material weakness in internal control over compliance but not a compliance related finding).

11.54 In evaluating the result of dual purpose tests, audit findings should be evaluated separately for the controls and compliance attributes tested. In planning the tests of compliance, the auditor should use the knowledge obtained of the relevant portions of internal control over compliance to identify types of potential noncompliance, to consider factors that affect the risk of material noncompliance, and to design appropriate tests of compliance. Thus, deviations resulting from tests of controls, including when those controls tests are part of a dual purpose sample, may result in a larger compliance sample for the related type of compliance requirement due to the increased risk posed by the deficiency in internal control over compliance.

11.55 As described in chapter 10 of this guide, the auditor's documentation of internal control and compliance tests should be distinguished from one

another so there is a clear distinction between the audit objectives and test results for each test so that separate conclusions may be reached on the internal control attributes and compliance attributes tested.

11.56 Another example of using a sample for multiple purposes is when auditors wish to use a single sample for testing for both Circular A-133 compliance audit objectives and financial statement audit objectives. Such an approach may cause additional complexities to consider because often there are different characteristics, and even different appropriate populations, for single audit and financial statement audit tests. Although many auditees record grant transactions within their general ledgers, populations used for financial statement purposes often do not align well with sampling populations for testing in a Circular A-133 compliance audit. The same principles described previously for dual purpose samples apply when a single sample is used to achieve both Circular A-133 compliance audit and financial statement audit objectives.

11.57 Although it is challenging to select samples that achieve both Circular A-133 compliance audit and financial statement objectives, they do occur. An example of a sample that achieves both Circular A-133 compliance audit and financial statement audit objectives is a sample of transactions inspected to determine the following:

- Indications of compliance with relevant laws, regulations, and compliance requirements over allowable costs and cost principles
- Indications of performance of internal controls over both allowable costs and cost principles and appropriateness of the expense for financial reporting
- Evidence that the recorded amount, account, and period are correct for financial reporting

Determining the Sample Size

11.58 This section discusses suggested minimum sample sizes as well as factors auditors may consider when using judgment to determine appropriate sample sizes. Because the objectives for tests of controls and tests of compliance are different, there are different factors to consider when determining sample sizes; thus, sample sizes should be considered separately for internal control testing and compliance testing. Audit documentation typically includes the inputs and assumptions for sample sizes to support each sample for every direct and material type of compliance requirement where sampling is used. Documentation is discussed in more depth in paragraphs 11.130–.134.

Control Testing Sample Size Table and Inputs

11.59 If the auditor determines that internal control over compliance is effectively designed and implemented (as discussed in chapter 9 of this guide), Circular A-133 requires that the auditor plan the audit to support a low level of assessed control risk of noncompliance.¹⁰ This requires the auditor to plan to obtain a high level of assurance that controls operate as designed. Therefore, generally, samples for control tests are designed to achieve a 90 percent to 95 percent confidence level (see AICPA Audit Guide *Audit Sampling* for further

¹⁰ In part II of this guide, the term *control risk of noncompliance* is used in order to be consistent with the term as used and defined in SAS No. 117. The term *control risk* is used only when directly citing Circular A-133. Both terms have the same meaning.

discussion of confidence levels). Because there are typically few other procedures that provide evidence of the effectiveness of controls, the sample size table that follows is designed to provide a high level of assurance. The following table provides suggested minimum samples sizes for very and moderately significant controls with limited to higher inherent risk of material noncompliance in a major program (see discussions of these terms that follow as well as a discussion of inherent risk of noncompliance in chapter 6 of this guide).

| Control Testing Sample Size Table | |
|--------------------------------------------------------------------------------------------------------|------------------------------------------------------|
| <i>Significance of Control and Inherent Risk of Compliance Requirement</i> | <i>Minimum Sample Size 0 deviations expected</i> |
| Very significant and higher inherent risk | 60 |
| Very significant and limited inherent risk or Moderately significant and higher inherent risk | 40 |
| Moderately significant and limited inherent risk | 25 |

The previous sample size table is appropriate for sampling from populations of 250 items or greater. Small population testing guidance is discussed in paragraphs 11.86–.89.

11.60 The suggested minimum sample sizes are designed to provide sufficient appropriate audit evidence that controls are operating effectively in many Circular A-133 compliance audit testing situations. However, auditors may need to use professional judgment to determine if larger sample sizes are warranted in order to obtain sufficient appropriate audit evidence that controls are functioning in their particular circumstances. For example, there may be additional risks (for example, change in the design of the control or change in personnel operating the control), or the auditor may expect deviations (see discussion that follows). It is important to recognize that if controls are not deemed effective, further control testing may not be warranted. In such situations where internal control over some or all of the compliance requirements for a major program is not deemed effective, refer to chapter 9 of this guide for further guidance.

Significance of Control Being Tested

11.61 The auditor may vary the type or amount of evidence obtained regarding the effectiveness of individual controls selected for testing based on the significance associated with the control. All controls that the auditor determines are to be tested to mitigate the risk of material noncompliance are significant controls, but a spectrum exists concerning the significance of each control. An important factor in determining the significance of a control is the potential magnitude of noncompliance (both qualitatively and quantitatively) if the particular control were to fail. The auditor should use the information

gathered by performing the risk assessment procedures, including the audit evidence obtained in evaluating the design of controls and determining whether they have been implemented, as audit evidence to support the risk assessment. The risk assessment should be used to determine the nature, timing, and extent of further audit procedures to be performed for each control selected for testing as well as to assist the auditor in determining what controls are very significant or moderately significant because minimum sample sizes differ (due to different desired confidence levels and tolerable deviation rates).

11.62 The higher and more pervasive the risk relating to a given control objective (that is, "what could go wrong" risk), the greater the need for assurance on relevant preventive and detective controls to achieve a specific control objective, and the more likely it is that the auditor will assess greater significance to the related controls. Several factors may be considered in determining the significance level of a control including whether the program is identified as higher risk in the *Compliance Supplement* and the potential magnitude of noncompliance to the program. For example, with respect to the Allowable Costs/Cost Principles type of compliance requirement, if payroll is a large portion of the expenditures (in volume or dollars, or both) for the program, then the major control points related to payroll more likely would be considered very significant. However, for a program for which payroll is a smaller portion of the expenditures, these controls may be considered moderately significant or potentially not significant to the program.

11.63 A factor that may cause a control to be considered moderately significant is the existence of other complementary, compensating, or redundant controls. If the auditor plans the control testing level assuming reliance on complementary, compensating, or redundant controls, the auditor should obtain sufficient appropriate audit evidence on the effectiveness of the complementary, compensating, or redundant controls. This means that multiple controls necessary to achieve the control objective will be tested for operating effectiveness. In that case, each control may be tested as a moderately significant control.

11.64 If the auditor identifies that a tested control does not operate effectively, the auditor may become aware of the existence of complementary, compensating, or redundant controls that, if effective, may limit the severity of the deficiency of the original tested control and prevent it from being a significant deficiency or material weakness in internal control over compliance. In these circumstances, the auditor may consider the effects of complementary, compensating, or redundant controls provided the auditor obtains sufficient appropriate audit evidence that such controls are effective. This means that multiple controls would be tested for operating effectiveness.

Inherent Risk of Noncompliance Factors

11.65 Factors that may suggest higher inherent risk of noncompliance include the following (see also chapter 6 of this guide):

- New program with little history with compliance requirement
- Complex processing (for example, nonroutine versus routine, non-systematic versus systematic, manual versus programmed) or judgment
- Significant deficiencies or material weaknesses in internal control over compliance observed in the past

- Correspondence from program officials indicating potential problems
- Lack of adherence to applicable laws and regulations in prior years
- High auditee turnover in a particular area
- Very high volume of activity
- Substantial change in the policies, processes, or personnel associated with the compliance requirement
- The program has been identified as higher risk by the OMB in the *Compliance Supplement*

It is important to note that the size of the program does not necessarily affect the potential for noncompliance. The presence of one or more of the factors listed previously may lead the auditor to determine that there is higher inherent risk of noncompliance; however, the auditor uses professional judgment to determine whether the number and combination of risk factors present higher or limited inherent risk of material noncompliance.

11.66 In order to properly apply the sampling tables illustrated in this chapter, it is useful to understand the inputs and assumptions underlying the suggested minimums (that is, confidence level, tolerable deviation rate, expected deviation rate). These items are discussed in the following, and the AICPA Audit Guide *Audit Sampling* provides an extensive discussion of the concepts.

Confidence Level and Tolerable Deviation Rate

11.67 Although the sample sizes in the table in paragraph 11.59 are all designed to provide a high level of assurance, the inputs for the 3 sample sizes differ in terms of confidence level and tolerable deviation rate.¹¹ The tolerable deviation rate for control tests is the maximum rate of deviation from a prescribed control that auditors are willing to accept without altering the planned assessed level of control risk of noncompliance. Auditors seeking a high level of assurance related to controls (low control risk of noncompliance) from a test of control often set a risk of overreliance of 10 percent or less with a tolerable deviation rate of 10 percent or less. The more significant the control, the higher the expected performance of the control (that is, the lower the tolerable deviation rate). A higher desired level of assurance (that is, higher desired confidence level) results in a larger sample size to provide the appropriate assurance. In assessing the tolerable deviation rate, the auditor may consider that although deviations from pertinent controls increase the risks of material noncompliance, such deviations do not always result in noncompliance.

Expected Deviation Rate

11.68 For Circular A-133 compliance audits, the auditor often plans for zero deviations in the sample. The sample sizes in the previous table are based on an expectation of zero deviations in the sample and a high level of assurance. If testing discovers no deviations, then a high degree of assurance is achieved that the control is being performed at an acceptable level to be effective. When

¹¹ The suggested minimum sample sizes are consistent with sample sizes provided in tables A-1 and A-2 of appendix A in the AICPA Audit Guide *Audit Sampling*. Although the sample sizes are consistent with statistically-based tables, the sample sizes provided in this chapter can be used for either statistical or nonstatistical sampling.

more deviations are encountered than were planned for, the auditor has not met the planned audit objective.

11.69 All deviations (whether expected or not) should be investigated to determine the potential effect on the program. Although not all deviations will lead to a finding, this guidance is written from the perspective of planning for zero deviations in the sample. Auditors may develop their own sample sizes with planned deviations. The AICPA Audit Guide *Audit Sampling* provides tables and guidance for auditors desiring to design audit samples when deviations are expected.¹² See paragraphs 11.100–.108 for discussion relating to when deviations are found in a sample.

Compliance Testing Sample Size Table and Inputs

11.70 The auditor typically performs a broad array of procedures to provide a reasonable basis for expressing an opinion on compliance for each major program. In a Circular A-133 compliance audit, just as in a financial statement audit, other audit procedures typically precede compliance audit sampling. For example, risk assessment procedures typically precede substantive procedures. Similarly, it is common for some controls-related procedures to be conducted prior to compliance testing (for example, understanding and testing the control environment). Before designing a compliance audit sample, it is also common for the auditor to consider whether there are individually important items that may be selected for testing prior to selecting a compliance sample (see paragraphs 11.21–.28). The auditor should consider other audit procedures when determining the appropriate sample size for compliance testing.

11.71 The risk of material noncompliance consists of inherent risk of non-compliance and control risk of noncompliance. The assurance required from a compliance sample and, therefore, the determination of the minimum compliance sample size, depends on the risk of material noncompliance remaining after other audit procedures (for example, risk assessment procedures, substantive analytical procedures, tests of individually important items) have been executed. If the auditor gathers evidence that controls over compliance are effective through tests of controls, and other audit procedures do not identify instances of noncompliance or identify specific heightened risk factors, and the auditor determines that additional testing via audit sampling is warranted, it is likely the remaining risk of material noncompliance would be low or moderate. Conversely, if tests of controls identify weaknesses in the controls over compliance, or other audit procedures identify instances of noncompliance or identify specific heightened risk factors, it may lead the auditor to assess the risk of material noncompliance as high or moderate.

11.72 The following table provides suggested minimum sample sizes associated with high, moderate, and low remaining risk of material noncompliance. The remaining risk of material noncompliance is an indicator of the desired level of assurance. A high remaining risk of material noncompliance indicates

¹² If internal control over compliance is deemed likely to be ineffective, Circular A-133 states that the auditor should assess control risk at the maximum and consider whether any additional compliance tests are required because of ineffective internal control. The auditor could consider testing compensating or redundant controls as described in paragraphs 11.63–.64. If no compensating or redundant controls are operating effectively, the auditor also should report a significant deficiency or material weakness in internal control over compliance as part of the audit findings. (Chapter 13, "Auditor Reporting Requirements and Other Communication Considerations in a Single Audit," discusses the reporting of significant deficiencies and material weaknesses.)

that a high level of assurance is desired to meet the audit objective. Desired level of assurance is discussed in more depth in paragraphs 11.76–.81.

Compliance Testing Sample Size Table

| <i>Desired Level of Assurance (Remaining Risk of Material Noncompliance)</i> | <i>Minimum Sample Size 0 exceptions expected</i> |
|--------------------------------------------------------------------------------------|------------------------------------------------------|
| High | 60 |
| Moderate | 40 |
| Low | 25 |

The previous sample size table is appropriate for sampling from populations of 250 items or greater. For smaller populations, see testing guidance in paragraphs 11.86–.89.

11.73 The minimum sample sizes in the previous table may be applied for each direct and material compliance requirement for each major program.¹³ Although the minimum sample sizes suggested in the table often provide the appropriate extent of testing, auditors may use professional judgment to determine if larger sample sizes are warranted in order to obtain sufficient appropriate audit evidence in particular circumstances. Depending on the nature of the compliance requirement, the results of other procedures performed during the audit, and the risks and complexities of the sampling population, there may be situations when larger sample sizes would be more appropriate than the proposed minimum sample sizes. For example, if there were significant deficiencies noted with the related controls, the auditor may expand testing to support the conclusion on compliance.

11.74 The sample sizes provided in the table are based on an expectation of zero exceptions and varying levels of assurance or confidence. A higher remaining risk of material noncompliance results in a need for a higher level of assurance (that is, a higher desired confidence level) and a larger sample size. Each type of compliance requirement tested should be evaluated separately for purposes of determining sample size. If the appropriate sample size is tested and no exceptions are discovered, then the planned degree of assurance has been obtained.

11.75 Many Circular A-133 compliance audits will include a spectrum of compliance testing sample sizes, meaning that some types of compliance requirements may present a high remaining risk of material noncompliance and would thus require a sample that provides high assurance, whereas other types of compliance requirements may present a low remaining risk of material noncompliance.

Desired Level of Assurance

11.76 When planning a particular sample, the auditor should consider the relationship of the sample to the audit objective. Thus, to the extent each

¹³ The suggested minimum sample sizes are consistent with sample sizes provided in tables A-1 and A-2 of appendix A in the AICPA Audit Guide *Audit Sampling*. Although the sample sizes are consistent with statistically-based tables, the sample sizes provided in this chapter can be used for either statistical or nonstatistical sampling.

compliance test has a different objective, samples should be separately considered. As noted in the compliance testing sample size table, the primary determinant of the appropriate minimum sample size for a particular compliance test is the risk of material noncompliance remaining after considering other audit procedures (for example, risk assessment, controls testing, testing individually important items, substantive analytical procedures) and, therefore, the desired level of assurance.

11.77 The desired level of assurance or confidence from a compliance sample varies as the types of compliance requirements differ in importance and risk. There is also a broad array of audit procedures the auditor may use that contribute to the overall evidence of compliance. There is general consensus across audit sampling applications that high assurance is typically associated with 90 percent to 95 percent confidence levels. The confidence levels associated with moderate and low in the compliance table are considered appropriate in compliance testing associated with a Circular A-133 compliance audit.

11.78 As discussed previously, the basis for expressing an opinion on compliance for each major program often is based on multiple procedures. Although the combined totality of audit evidence gathered by the auditor should be sufficient to support a high level of assurance, an auditor may not need to design compliance samples to achieve high assurance when there are other sources of evidence beyond the compliance sample.

11.79 In evaluating the desired level of assurance, the auditor may consider the importance of the type of compliance requirement, inherent risk of noncompliance factors, the risk of fraud, and the results from tests of the operating effectiveness of controls for the type of compliance requirement. For example, if the auditor has obtained evidence that controls over compliance are properly designed and operating effectively to reduce the likelihood of material noncompliance, the auditor may assess the remaining risk of material noncompliance as moderate or low and similarly reduce the desired level of assurance from the compliance sample. A lower remaining risk of material noncompliance results in a need for a lower level of assurance from the sample and a smaller sample size. On the other hand, if tests of controls indicated that controls are not operating effectively and the auditor is not able to support a low assessed level of control risk of noncompliance for the major program, the auditor should assess control risk of noncompliance at the maximum. Maximum control risk of noncompliance may result in higher remaining risk of material noncompliance, and the desired level of assurance from the compliance test also increases to moderate or high to support an unqualified opinion on the auditee's compliance.¹⁴

11.80 As noted in the prior paragraph, the risk of material noncompliance is affected by the inherent risk of noncompliance for the particular type of compliance requirement. There are many factors that can affect inherent risk of noncompliance, for example, the regulatory environment, the significance of the particular requirement to the overall program, the complexity of relevant regulations, changes in regulations, or the experience the auditee has with the federal program. In assessing the remaining risk of material noncompliance,

¹⁴ However, if during the testing of the compliance sample, the auditor finds sufficient evidence of noncompliance to support an opinion other than unqualified, the auditor is not required to test remaining or additional items.

the engagement team may also consider the results of procedures performed in connection with the audit of the financial statements.

11.81 Auditors, in assessing inherent risk of noncompliance, typically assess risk factors associated with the types of compliance requirements being tested. Further, there are general risk factors which may suggest the need to obtain a higher level of assurance from an audit sample. Examples of such risk factors are discussed in paragraph 11.65. Audit risk of noncompliance considerations including inherent risk of noncompliance are also discussed in chapter 6 of this guide.

Tolerable Exception Rate

11.82 The tolerable exception rate for compliance tests is the maximum rate of compliance exceptions that auditors are willing to accept. The tolerable exception rate for all types of compliance requirements is related to program materiality. Materiality is considered in relation to each major program. The quantitative thresholds used to determine if an exception is an "audit finding" related to a major program is lower than the materiality used for planning the Circular A-133 compliance audit and expressing an opinion on the auditee's compliance (materiality is also discussed in chapter 6 and chapter 8, "Determination of Major Programs," of this guide).

11.83 The determination of major program materiality is a matter of professional judgment. The tolerable exception rate for a compliance sample testing nonmonetary compliance attributes (for example, Reporting type of compliance requirement) as well as monetary compliance attributes (for example, Allowable Costs/Cost Principles type of compliance requirement) is normally equal to or lower than the level of materiality for expressing an opinion on the auditee's compliance with requirements having a direct and material effect on each major program. For example, if program materiality is determined to be five percent of program expenditures, then the tolerable exception rate for a compliance sample testing monetary attributes would be five percent or less. Similarly, if a five percent exception rate for a nonmonetary compliance attribute is considered material, then the tolerable exception rate for compliance sample testing that nonmonetary attribute would be five percent or less. The compliance testing sample size table is based on a five percent tolerable exception rate for both nonmonetary and monetary attributes. If program materiality is set lower than five percent, then the tolerable exception rate would be lowered, and the minimum sample sizes may need to be adjusted upward. The AICPA Audit Guide *Audit Sampling* provides tables and guidance for auditors desiring to design audit samples for different tolerable exception rates.

Expected Population Exception Rate

11.84 The compliance testing sample size table is based on an expectation of no exceptions. If testing discovers no exceptions, then the desired level of assurance is obtained that compliance is effective. When more exceptions are encountered than were planned for, the auditor has not met the planned audit objective. Auditors may develop their own sample sizes with planned exceptions. Appendix A of the AICPA Audit Guide *Audit Sampling* provides tables and guidance for auditors desiring to design audit samples when exceptions are expected.

11.85 All exceptions (whether planned or not) should be investigated to determine the potential effect on the program. Although not all exceptions will

lead to a finding, the auditor should evaluate compliance exceptions (whether planned or not) for their nature and cause to determine the potential effect on the program.

Testing Small Populations

11.86 Some significant controls or instances of complying with a compliance requirement, or both, do not occur frequently (for example, submitting a required report). The following table provides suggested minimum sample sizes in testing small populations subject to controls and compliance requirements.¹⁵ *Small populations*, for purposes of this chapter, are defined as populations of fewer than 250 items.

Small Population Sample Size Table

| <i>Frequency and Population Size</i> | <i>Sample Size</i> |
|--------------------------------------|--------------------|
| Quarterly (4) | 2 |
| Monthly (12) | 2–4 |
| Semimonthly (24) | 3–8 |
| Weekly (52) | 5–9 |

11.87 For populations between 52 and 250 items, a rule of thumb some auditors follow is to test a sample size of approximately 10 percent of the population, but the size is subject to professional judgment, which would include specific engagement risk assessment considerations.

11.88 For more significant controls discussed in paragraphs 11.61–.64, or for more significant types of compliance requirements, the auditor may determine the appropriate sample size is on the larger end of the ranges displayed in the small population sample size table.

11.89 The auditor may consider the size of the population by reference to the defined sampling unit. For example, in some cases, the auditor may need to consider the populations from several locations or components; if there were weekly controls over the occurrence of expenses at each of 40 departments, the population of weekly expense test controls would be 2,080 (52×40), and this would not be a small population.

Selecting Sample Items for Testing

11.90 Once the population of transactions or items relevant for a control or type of compliance requirement is identified, the auditor may select items for testing from a physical or electronic representation of the population. For example, a physical representation might be a printout of expenditures for the period.

11.91 Sample items should be selected so the sample can be expected to be representative of the sampling population and, thus, the results can be

¹⁵ The table is adapted from table 3-5, "Small Population Sample Size Table," in the AICPA Audit Guide *Audit Sampling*.

appropriately projected to the population. The goal of sample selection, a representative sample, is the same for both nonstatistical and statistical sampling. For statistical sampling, it is necessary to use an appropriate random sampling method such as simple random sampling or systematic sampling. In nonstatistical sampling, the auditor uses a sample selection approach that approximates a random sampling approach.¹⁶ Please note that the *Compliance Supplement* provides specific guidance on sample selection for certain types of major programs.¹⁷

11.92 As noted previously in the discussion on determining the appropriate sampling population, it is common for control testing samples to be drawn from a population that contains multiple major programs (assuming common controls, policies, procedures, and competence of personnel). Experience has shown that it is preferable to select separate compliance samples from each major program because the separate samples provide clear evidence of the tests performed, the results of those tests, and the conclusions reached, which support the auditor's opinion on each major program.

11.93 An overview of selection methods follows. For nonstatistical sampling, the auditor may select the sample using any of the three techniques the follow. However, the haphazard selection technique is not appropriate for statistical sampling. The AICPA Audit Guide *Audit Sampling* contains additional guidance on applying the techniques discussed in the following as well as additional sampling techniques such as block and sequential.

Random Selection

11.94 Random selection provides an equal chance of selection to each sampling item in the population. To perform this selection, the auditor may select a random sample by matching random numbers generated by a computer or selected from a random number table, or by generating random numbers with software such as Microsoft Excel or commercial audit software packages.

Haphazard Selection

11.95 The haphazard selection technique represents the auditor's best attempt at making a random selection judgmentally without the use of a structured selection technique (for example, random numbers or tables). It is the selection of sampling units without any intentional bias; that is, without any special reasoning for including or omitting items from the sample. Haphazard selection does not consist of selecting sampling units in a careless manner. For example, when the physical representation of the population is a file cabinet drawer of vouchers, a haphazard sample of all vouchers processed for the year 20XX might include any of the vouchers that the auditor haphazardly pulls from the drawer, regardless of each voucher's size, shape, location, or other physical features.

¹⁶ A properly designed nonstatistical sampling application that considers the same factors that would be considered in a properly designed statistical sample can provide results that are as effective as those from a properly designed statistical sampling application. Please see the AICPA Audit Guide *Audit Sampling* for further discussion of nonstatistical and statistical sampling.

¹⁷ For example, the *OMB Circular A-133 Compliance Supplement* provides guidance on how to select items in a research and development cluster that includes multiple federal agencies and award types.

11.96 The auditor using haphazard selection is normally careful to avoid distorting the sample by selecting, for example, only large, only unusual, only convenient, or only physically small items or by omitting such items as the first or last in the physical representation of the population. The goal is to select a sample without bias. Although haphazard sampling is useful for nonstatistical sampling, it is not appropriate for statistical sampling because it does not allow the auditor to measure the probability of selecting a combination of sampling units.

Systematic Selection With a Random Start

11.97 Systematic selection with a random start determines a uniform interval by dividing the number of physical units in the population by the sample size. A starting point is randomly selected in the first interval, and one item is selected throughout the population at each of the uniform intervals from the starting point. For example, if the auditor wishes to select 60 items from a population of 12,000 items, the uniform interval is every 200th item. The auditor randomly selects the first item from within the first interval and then selects every 200th item from the random start.

11.98 If the deviation pattern is random, then systematic selection is equivalent to simple random selection. In the absence of a known pattern in the population, it is a practical and efficient alternative to simple random selection, particularly when items are being selected manually from a population.

Performing the Test Procedures

11.99 After the sampling plan has been designed, and the auditor has selected the sample, if the auditor is not able to apply the planned audit procedures or appropriate alternative procedures to selected items, the auditor should consider the reasons for this limitation and should ordinarily consider those selected items to be control deviations or compliance exceptions from the prescribed policy or procedure for the purpose of evaluating the sample. Additional guidance on performing the sampling plan, including how to handle sample items that are voided documents, unused or inapplicable documents, or documents that cannot be located, can be obtained in chapter 3 of the AICPA Audit Guide *Audit Sampling*.

Investigate and Understand the Nature and Cause of Control Deviations and Compliance Exceptions

11.100 In addition to providing an auditor's opinion on compliance for each major program, Circular A-133 requires the auditor to report on deficiencies in internal control over compliance which constitute significant deficiencies or material weaknesses in internal control over compliance. Circular A-133 also requires the auditor to report known questioned costs when the likely questioned costs are \$10,000 or more.¹⁸ Thus, whenever a control deviation or a compliance exception is identified, the auditor should evaluate the nature and cause of the deviation or exception. Understanding the potential effect on the program will assist the auditor in determining whether sufficient appropriate evidence has been obtained to support the auditor's opinion on compliance and whether to report an internal control finding, compliance finding, or both.

¹⁸ See footnote 2 in paragraph 11.08 for further discussion on *known questioned costs* and *likely questioned costs*.

11.101 In evaluating deviations and exceptions, the auditor may consider factors such as the following:

- *Systematic nature of the deviation or exception.* If a control deviation or compliance exception is systematic in nature, it is more likely to lead to a finding than if the deviation or exception is contained to a subset of the population testing. Guidance regarding deviations or exceptions believed to be nonsystematic is provided in paragraphs 11.106–130.
- *Intentional deviation or exception.* The discovery of fraud requires a broader consideration of the possible implications than does the discovery of a deviation or exception attributable to a mistake or lack of understanding.
- *Pattern relative to past history.* Control deviations or compliance exceptions observed in the current audit that are similar in nature to deviations or exceptions that led to a finding or material noncompliance in past audits typically increases the likelihood that a finding will be reported, or that there is material noncompliance in the current year. The nature of the pattern may lead the auditor to perform additional tests to determine the effect of the deviation or exception. Further, an auditee's failure to correct previously identified deficiencies in internal control over compliance or compliance exceptions is also a relevant factor in the evaluation consideration.

Determine If Additional Testing Is Warranted in Response to an Observed Deviation or Exception

11.102 If exceptions are found and the likely questioned cost is close to the audit materiality level for a major program or the audit finding threshold of \$10,000, the auditor may conduct additional tests to better substantiate the likely questioned costs. In addition, if findings occur in a particular risky area of a major program, additional testing may be warranted to substantiate the compliance opinion.

11.103 The sample sizes in the controls and compliance sample size tables are based on an expectation of zero deviations/exceptions. The auditor may encounter an unexpected deviation or exception rate in a sample from a population that was expected to be deviation/exception free or to have a low incidence of deviation/exception. In such cases, it is important for the auditor to recognize that the sample is expected to be representative only with respect to the occurrence rate or incidence of deviations or exceptions, not their nature or cause. An unexpected deviation or exception may be indicative of other deviations or exceptions in the population. Where the auditor, expecting a negligible or zero deviation or exception rate, selected a small sample and found a deviation or exception rate slightly higher than expected, and the auditor believes the deviation or exception rate observed does not represent a reportable finding, it may be appropriate to extend the sample from that population, but the appropriate extension would not be small. More guidance on dealing with negligible exception rates is provided in the AICPA Audit Guide *Audit Sampling*.

11.104 In some instances, the auditor's understanding of the nature and cause of the deviation or exception may suggest the sample deviation/exception

rate is not likely to be representative of the population (that is, it is not a systematic error). In such instances, the auditor may consider whether to pursue additional evidence to indicate that the sample deviation or exception rate is not representative of the entire population (that is, the error can be contained to a specific subpopulation). To conclude that a deviation or exception is non-systemic typically requires the auditor to perform additional audit procedures to obtain sufficient appropriate audit evidence that the actual deviation or exception rate experienced in the sample is not representative of the deviation or exception rate in the population.

11.105 When the decision regarding reporting a finding is not straightforward, the auditor may consider reporting deviations and exceptions as findings and let the appropriate federal regulators investigate further.

Evaluating Sample Results

Evaluating Control Deviations

11.106 Whether the sample is statistical or nonstatistical, the auditor should evaluate the frequency and nature and cause of such deviations.

11.107 The controls sample size table in paragraph 11.59 is based on an expectation of zero deviations. When more deviations are encountered than were planned for, the auditor has not met the planned audit objective. In other words, although the auditor needs a *tolerance*, or tolerable deviation rate, in order to plan a sample, the observance of a deviation rate as high as the tolerable rate in a sample is not acceptable due to sampling risk (discussed in the following).

11.108 As previously discussed, when a control deviation is identified, the auditor should evaluate the nature and cause of the deviation. Control deviations should be evaluated to determine whether they are significant deficiencies or material weaknesses in internal control over compliance.

Calculating the Control Deviation Rate

11.109 Calculating the deviation rate in the control test sample involves dividing the number of observed deviations by the sample size. For example, if 3 deviations are observed in a sample of 60, the deviation rate is 5 percent ($3/60$). The deviation rate in the sample is the auditor's best estimate of the deviation rate in the population from which it was selected. Because the purpose of testing is generally to confirm the reliability of the control, it is common to assume that controls are effective when designing the audit plan. Thus, deviations observed in the sample are often important to the auditor's compliance testing strategy, depending on the deviation rate and reasons for the deviation.

Considering Sampling Risk Associated With Control Testing

11.110 When evaluating a sample for a test of controls, the auditor should give appropriate consideration to sampling risk. If the estimate of the population deviation rate (the sample deviation rate) is less than the tolerable deviation rate for the population, the auditor should consider the risk that such a result might be obtained even if the true deviation rate for the population exceeds the tolerable rate for the population. That risk is called *sampling risk*.

11.111 If an auditor performs a statistical sampling application, the auditor might use a table or computer program to assist in measuring the allowance for sampling risk. If the auditor performs a nonstatistical sampling application, sampling risk may not be directly measurable; however, it is generally appropriate for the auditor to conclude that the sample results do not support the planned assessed level of control risk of noncompliance if the rate of deviation identified in the sample exceeds the expected population deviation rate used in designing the sample (which is zero in the control testing sample size table).

11.112 The control sample size table is based on an expectation of zero deviations. When more deviations are encountered than were planned for, the auditor has not met the planned audit objective, and there is likely to be an unacceptably high risk that the true deviation rate in the population exceeds the tolerable rate due to sampling risk. In such a circumstance, after considering the reasons for the control deviation(s) and the number of deviations identified, the auditor may conclude it is appropriate to expand the test or perform other tests to include sufficient additional items to reduce the risk to an acceptable level.¹⁹ Rather than testing additional items, however, it is often more efficient in a Circular A-133 compliance audit to report a deficiency in internal control over compliance and, when testing compliance, to increase the auditor's assessed level of risk of material noncompliance and increase the extent of compliance testing to reflect the change in the control risk of noncompliance assessment.

Assessing the Potential Magnitude of a Deficiency in Internal Control Over Compliance

11.113 If the auditor finds deviations, he or she determines whether they are deficiencies in internal control over compliance and, if so, whether those deficiencies are material weaknesses, significant deficiencies, or just deficiencies in internal control over compliance. AU section 325, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1), requires the auditor to consider the likelihood and magnitude of deficiencies, individually or in combination (see chapter 9 of this guide).²⁰

Reaching an Overall Conclusion on Tests of Controls

11.114 The overall conclusion about the effect that the evaluation of the sample results will have on the assessed level of control risk of noncompliance, the risks of material noncompliance, and, thus, on the nature, timing, and extent of planned compliance tests requires professional judgment. If the sample results, along with other relevant audit evidence, support the planned low assessed level of control risk of noncompliance, the auditor may have no need to modify planned compliance tests. If a low assessed level of control risk of noncompliance is not supported, the auditor should consider either performing further tests of other controls that could result in supporting the planned level of control risk of noncompliance or increasing the assessed level of control risk of noncompliance and altering the nature, timing, or extent of the planned compliance tests accordingly.

¹⁹ Additional guidance on expanding the sample is provided in chapter 3, "Nonstatistical and Statistical Audit Sampling in Tests of Controls," of the AICPA Audit Guide *Audit Sampling*.

²⁰ When the deficiency in internal control over compliance relates to monetary values, chapter 3 of the AICPA Audit Guide *Audit Sampling* provides an approach to quantifying the potential magnitude of monetary exposure to noncompliance.

11.115 Additional guidance regarding whether there is evidence of a finding, significant deficiency, or material weakness in internal control over compliance is found in chapters 9 and 13, "Auditor Reporting Requirements and Other Communication Considerations in a Single Audit," of this guide.

Evaluating Compliance Exceptions

11.116 Whether the sample is statistical or nonstatistical, the auditor should evaluate the frequency and, if applicable, the magnitude of noncompliance as well as the nature and cause of the noncompliance to reach an overall conclusion on compliance with a particular type of compliance requirement.

Calculating the Compliance Exception Rate or Likely Questioned Costs

11.117 For nonmonetary compliance attributes, calculating the exception rate in the compliance test sample involves dividing the number of observed exceptions by the sample size. For example, if 3 exceptions are observed in a sample of 60, the exception rate is 5 percent (3/60). The exception rate in the sample generally is the auditor's best estimate of the exception rate in the population from which it was selected. Exceptions observed in the sample are important to the auditor's compliance testing strategy and should be evaluated to determine whether to report material noncompliance. Further, compliance findings may affect the overall opinion regarding material compliance.

11.118 Although compliance testing in a Circular A-133 compliance audit often involves monetary amounts, the focus of the testing is on whether or not there is evidence of compliance to support the auditor's opinion on compliance. Additionally, when noncompliance is discovered related to monetary transactions of a program, Circular A-133 requires the auditor to determine both the known questioned costs and likely questioned costs associated with audit findings. The estimation of likely questioned costs may require the projection of sample results to determine the effect on the auditor's opinion on compliance and whether a finding is required to be reported in the Schedule of Findings and Questioned Costs.²¹ The auditor is not required to expand his or her test work to definitively determine the total questioned costs because there is no requirement in Circular A-133 to report an exact amount or a statistical projection of likely questioned costs. Rather, Circular A-133 requires the auditor to consider the effect of likely questioned costs on the auditor's opinion on compliance and include an audit finding when the auditor's estimate of likely questioned costs is greater than \$10,000.

11.119 As noted previously, the auditor should evaluate the finding to calculate an estimate of potential total questioned costs in order to determine whether likely questioned costs exceed \$10,000. For example, if the auditor specifically identifies \$7,000 in known questioned costs for a type of compliance requirement but, based on his or her projection of the exception to the population, develops an estimate that the total likely questioned costs are approximately \$60,000, the auditor should report a finding that indicates only the known questioned costs of \$7,000. Chapter 13, "Auditor Reporting Requirements and Other Communication Considerations in a Single Audit," of this guide further discusses reporting findings based on likely questioned costs. If likely questioned costs exceed program materiality, the auditor may consider

²¹ See footnote 2 in paragraph 11.08 for more information.

qualifying the audit opinion for that program (chapter 6 of this guide further discusses materiality considerations as it relates to opining on major programs).

11.120 There are 2 approaches commonly used to project compliance results to a monetary population. First, if the monetary compliance exceptions are 100 percent errors (for example, the entire sampling unit contains all allowable or unallowable cost), from a population of similar sized transactions, the same exception rate technique discussed previously for nonmonetary compliance attributes can be applied to the population of dollars to estimate the likely questioned costs. For example, if 3 exceptions are observed in a sample of 60, the exception rate is 5 percent (3/60). Assuming the 3 exceptions were 100 percent errors, and the population is made up of homogeneous transaction, the 5 percent exception rate would be applied to the total population monetary value to estimate likely questioned costs. Continuing the example, if the total value of the sampling population were \$1,000,000, then the likely questioned costs would be \$50,000.

11.121 The second approach to projecting compliance sample results to the population applies the noncompliance or questioned cost rate of dollar noncompliance observed in the sample to the population. For example, an auditor might have selected a sample that sums to \$10,000 and observed known questioned costs of \$200, or 2 percent of the recorded amount of the expenditures tested. If the total recorded amount in the expenditures population is \$1,000,000, then projected likely questioned cost is \$20,000 ($\$1,000,000 \times 2\%$). This approach is especially useful when a sampling unit is found to be only partially incorrect.

11.122 See the AIPCA Audit Guide *Audit Sampling* for additional methods to calculate the compliance exception rate or likely questioned costs.

Considering Sampling Risk Associated With Compliance Testing

11.123 When evaluating a sample for a test of compliance, the auditor should give appropriate consideration to sampling risk. If the estimate of the population exception rate (the sample exception rate) for nonmonetary attributes is less than the tolerable exception rate for the population, or if the estimate of likely questioned costs is less than tolerable error for a monetary population, the auditor might consider the risk that such a result might be obtained even if the true exception rate or questioned costs for the population exceeds the tolerable rate or tolerable error, respectively, for the population.

11.124 If an auditor performs a statistical sampling application, the auditor might use a table or computer program to assist in measuring the allowance for sampling risk. If the auditor performs a nonstatistical sampling application, sampling risk may not be directly measureable; however, it is generally appropriate for the auditor to conclude that the sample results do not support an acceptable level of compliance if the rate of exception or likely questioned costs identified in the sample exceeds the expected exception rate used in designing the sample (which is zero in the compliance testing sample size table).

11.125 The compliance sample size table in paragraph 11.72 is based on an expectation of zero exceptions. When more exceptions are encountered than were planned for, the auditor has not met the planned audit objective, and there is likely to be an unacceptably high risk that the true exception rate in the population exceeds the tolerable rate. In such a circumstance, after considering the reasons for the compliance exception(s) and the number and magnitude of exception(s), the auditor may conclude it is appropriate to expand testing or

perform other tests to include sufficient additional items to reduce the risk of material noncompliance to an acceptable level.²² Alternatively, rather than expand the scope of testing to improve the precision of the projected error, the auditor may consider it prudent to report the exceptions as a finding and evaluate the effect that the sample results has on the assessed level of risk of material noncompliance and the overall compliance opinion.

11.126 In evaluating whether an exception is a finding, it is particularly important to consider sampling risk when the projected likely cost is close to the reporting threshold of \$10,000. The auditor would generally conclude that there is an unacceptable risk that the true questioned costs exceeds the reporting threshold. Even when the projected likely questioned costs are considerably less than the reporting threshold, the auditor should consider the risk that such a result might be obtained even though the true questioned costs for the population exceeds the reporting threshold (allowance for sampling risk). The smaller the sample, the greater the associated uncertainty or sampling risk associated with that sample.

Effect of Compliance Testing Results on Internal Control Results Reporting

11.127 The auditor should relate the evaluation of the compliance testing sample to other relevant audit evidence when forming a conclusion about compliance as well as internal control over compliance. If compliance testing results in exceptions, the auditor should relate this testing to the results of tests of internal controls. A compliance exception is an indicator of a potential deficiency in internal control over compliance.

Reaching an Overall Conclusion on Tests of Compliance

11.128 The overall conclusion about the effect that the evaluation of the sample results has on his or her assessed level of risk of material noncompliance and, thus, on the overall compliance audit opinion, requires the auditor to use professional judgment. If the sample results, along with other relevant audit evidence, support other than an unqualified opinion, the auditor should modify the opinion accordingly.

11.129 For nonmonetary compliance attributes (for example, a report is submitted on a timely basis), the auditor should document noted exceptions and consider the guidance contained in Circular A-133 to determine if the finding should be included in the Schedule of Findings and Questioned Costs in the Circular A-133 compliance audit reporting package. For monetary attributes, the auditor should also document noted exceptions (questioned costs), and if the known or likely questioned cost exceeds \$10,000, the auditor should report the finding.

11.130 When the auditor finds a compliance exception that, in itself, does not meet the criteria of a finding, the auditor would typically gain assurance that the exception may, indeed, be omitted from the Schedule of Findings and Questioned Costs. Circular A-133 does not require the auditor to expand his or her sample in the case of exceptions, there may be additional procedures performed to support the conclusion that the exception is not a finding, for example if the questioned costs are close to the reporting threshold of \$10,000. In

²² Additional guidance on expanding the sample is provided in chapter 3 of the AICPA Audit Guide *Audit Sampling*.

all cases where an initial exception is determined not to be a finding, the auditor should document the rationale for omitting the exception from the Schedule of Findings and Questioned Costs in the single audit reporting package.

Documenting the Sampling Procedure

11.131 According to paragraph 40 of SAS No. 117, the auditor should document his or her responses to the assessed risks of material noncompliance, the procedures performed to test compliance with applicable compliance requirements,²³ and the results of those procedures, including any tests of controls over compliance. The following paragraphs provide information related to documenting sampling procedures and the results of such procedures as it applies to a compliance audit.

11.132 As noted in chapter 2, "Planning Considerations of *Government Auditing Standards*," of this guide, AU section 339, *Audit Documentation* (AICPA, *Professional Standards*, vol. 1), provides requirements and guidance on the form, content, extent, retention, and confidentiality of audit documentation. AU section 339 contains guidance on documenting significant findings or issues; identifying the preparer and reviewer of audit documentation; documenting specific items tested; documenting departures from relevant SASs; revising audit documentation after the date of the auditor's report; and ownership and confidentiality of audit documentation. Among other things, AU section 339 states that an auditor should prepare audit documentation that enables an experienced auditor, having no previous connection to the audit, to understand the following:

- The nature, timing, and extent of auditing procedures performed to comply with SASs and applicable legal and regulatory requirements (for example, *Government Auditing Standards* and other single audit requirements such as Circular A-133)
- The results of the audit procedures performed and the audit evidence obtained
- The conclusions reached on significant matters
- That the accounting records agree or reconcile with the audited financial statements or other audited information

11.133 In addition to the requirements found in AU section 339, *Government Auditing Standards* includes several additional audit documentation requirements that are described in chapter 2 of this guide.

11.134 The form and extent of documentation related to sampling are influenced by numerous factors, which may include the size and complexity of the auditee, the nature and complexity of the auditee's internal control over compliance, the nature and complexity of the compliance requirements, and the auditee's past experience relative to compliance.

11.135 Although AU section 339, AU section 350, and this guide do not contain a list of specific documentation requirements for audit sampling applications, examples of items that the auditor typically documents include the following:

²³ See footnote 5 in paragraph 11.26.

- A description of the control or type of compliance requirement being tested
- A definition of the population and the sampling unit, including how the auditor considered the completeness of the population (discussed in paragraphs 11.33–.41)
- A definition of the deviation or exception condition (discussed in paragraphs 11.50–.51)
- The desired confidence or assurance level, the tolerable deviation or exception rate, and the expected population deviation or exception rate²⁴ (as discussed in paragraphs 11.58–.89)
- The chosen sample size²⁵
- The sample selection method such as random, haphazard, or systematic selection (as discussed in paragraphs 11.90–.98)
- The selected sample items, which would include identifying characteristics of the specific items tested, clear documentation to support both controls and compliance testing when dual purpose testing is applied (as discussed in paragraphs 11.52–.57), and resolution of any documents that cannot be located (as discussed in paragraph 11.99). Paragraph .21 of AU section 339 provides several alternatives regarding how an auditor can identify selected sample items in audit documentation
- An evaluation of the sample, including the following:
 - The number of deviations or exceptions found in the sample
 - Important qualitative aspects of the deviation(s) or exception(s)
 - The projected population deviation or exception rate
 - A determination of whether the sample results support the test objective
 - The effect of the evaluation on other audit procedures (for example, if tests of controls do not allow the auditor to support a low assessed level of control risk of noncompliance for major programs, consideration of the effect on subsequent tests of compliance)
 - The auditor's determination of known questioned costs and estimation of likely questioned costs
 - A determination whether observed deviation(s) or exception(s) require a modification of the auditor's opinion on

²⁴ Use of a sample size from the tables in this chapter provides adequate documentation of the underlying inputs to the table (that is, tolerable deviation/exception rate, confidence, and expected deviation/exception rate). However, the support for the sample size used within the range provided, which depends on factors such as the significance of the control tested or the remaining risk of material noncompliance, is based on auditor judgment and is not implicit in the tables and, thus, is important in documenting the sampling applications and procedures.

²⁵ See footnote 24. Similarly, if an auditor determines a sample size using other than the suggested minimums from the tables in this chapter (for example, some audit organizations may use their own internal guidance that results in a sample size that is slightly different from the tables in this chapter), the basis for that determination would also be important in documenting the sampling applications and procedures.

compliance or will result in a finding and, if not, how the auditor considered sampling risk (as discussed in paragraphs 11.106–.130)

- Any qualitative factors considered significant in making the sampling, selections, assessments, and judgments which may include multiple major programs, multiple components, clusters, or other factors
- A summary of the overall conclusion (if not evident from the results)

American Recovery and Reinvestment Act Considerations *

11.136 Paragraph 11.37 notes that the auditor should select a sample in such a way that the sample can be expected to be representative of the population. Because Recovery Act guidance does not require separate samples of Recovery Act expenditures within a program, an individual sample will be considered to be representative of the population when the sample includes both Recovery Act program expenditures and non-Recovery Act program expenditures.

11.137 When planning compliance testing for each major program, the auditor may use judgment to determine what items, if any, represent individually important items that may be individually tested and separated from the remaining population. When determining individually important items, the auditor may determine that certain Recovery Act expenditures represent individually important items. See the discussion beginning in paragraph 11.21 for more information on testing individually important items.

* Information in this guide related to the American Recovery and Reinvestment Act of 2009 (Recovery Act) is based upon the latest information available at the time of this writing. However, this information is subject to change because guidance from the OMB is being issued and updated on an ongoing basis. It is important that recipients of Recovery Act funding, and their auditors, monitor the guidance issued. For the latest OMB guidance, go to the OMB website at www.whitehouse.gov/omb/recovery/default. Information can also be found at the Recovery Act Resource Center on the Governmental Audit Quality Center website, which is open to the public at www.aicpa.org/INTERESTAREAS/GOVERNMENTALAUDITQUALITY/RESOURCES/RECOVERYACTRESOURCECENTER/Pages/default.aspx and at the U.S. Government's official Recovery Act website at www.recovery.gov.

Chapter 12

Audit Considerations of Federal Pass-Through Awards

Note: The audit required by the Single Audit Act Amendments of 1996 and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133), should be performed in accordance with *Government Auditing Standards*. Part I, "Government Auditing Standards Audits," (chapters 2–4 of this guide) discusses financial statement audits under generally accepted auditing standards and *Government Auditing Standards*. The guidance in parts I and II, "Circular A-133 Audits," (chapters 5–14 of this guide) is applicable for those auditors performing an audit under the Single Audit Act Amendments of 1996 and Circular A-133.

Information related to the American Recovery and Reinvestment Act of 2009 (Recovery Act) can be found in a section located at the end of each chapter in part II of this guide. See the section titled "American Recovery and Reinvestment Act Considerations" beginning at paragraph 12.48 in this chapter. See also the preface section titled "Impact of the American Recovery and Reinvestment Act of 2009 on Single Audits."

Introduction

12.01 Many nonfederal entities receiving federal awards make pass-through payments of federal awards to other entities that are considered subrecipients. The amount of those payments may be material to the pass-through entity's financial statements,¹ individual major programs, or both. This chapter discusses the auditor's consideration of pass-through federal awards in an audit of both pass-through entities and subrecipients of federal awards under Circular A-133. It also discusses the auditee's and auditor's responsibilities with respect to activities carried out by vendors. An auditee with multiple federal funding agreements may be a pass-through entity in regard to some awards, a subrecipient in regard to other awards, and a vendor with respect to other agreements.

Definitions

12.02 Circular A-133 includes the following definitions that are relevant to pass-through awards:

Federal award. Federal financial assistance and federal cost-reimbursement contracts that nonfederal entities receive directly from federal awarding

¹ As discussed in the AICPA Audit and Accounting Guide *State and Local Governments*, the auditor's consideration of materiality for purposes of planning, performing, evaluating the results of, and reporting on the audit of the financial statements of a state or local government is based on opinion units. See that guide for further guidance.

agencies or indirectly from pass-through entities. It does not include procurement contracts, under grants or contracts, used to buy goods or services from vendors.

Nonfederal entity A state, local government, or non-profit organization (not-for-profit entity or NFP).

Recipient. A nonfederal entity that expends federal awards received directly from a federal awarding agency to carry out a federal program.

Pass-through entity. A nonfederal entity that provides a federal award to a subrecipient to carry out a federal program.

Subrecipient. A nonfederal entity that expends federal awards received from a pass-through entity to carry out a federal program but does not include an individual who is a beneficiary of such a program. A subrecipient may also be a recipient of other federal awards directly from a federal awarding agency.

Vendor. A dealer, distributor, merchant, or other seller providing goods or services that are required for the conduct of a federal program. These goods or services may be for an organization's own use or for the use of beneficiaries of the federal program.

Applicability of Circular A-133

12.03 Circular A-133 applies to both recipients expending federal awards received directly from federal awarding agencies and subrecipients expending federal awards received from a pass-through entity. Accordingly, both recipients and subrecipients that expend \$500,000 or more in federal awards should have a single or program-specific audit in accordance with Circular A-133. (Chapter 14, "Program-Specific Audits," of this guide discusses program-specific audits.)

12.04 The determination of when a federal award is expended is based on when the activity related to the award occurs. With respect to federal awards passed through to subrecipients, the activity that requires the pass-through entity to comply with laws, regulations, and the provisions of contracts or grant agreements is the disbursement of funds to subrecipients. The activity that requires subrecipients to comply with laws, regulations, and the provisions of contracts or grant agreements is the expenditure of the pass-through award.

12.05 Payments received by a vendor for goods or services provided in connection with a federal program are not considered federal awards. Furthermore, Medicaid payments to a subrecipient for providing patient care services to Medicaid-eligible individuals are not considered federal awards expended under Circular A-133 unless a state requires the funds to be treated as federal awards expended because reimbursement is on a cost-reimbursement basis.

12.06 If a pass-through entity provides federal awards to subrecipients, the pass-through entity should monitor the subrecipients' activities to provide reasonable assurance that the subrecipients administer federal awards in compliance with federal requirements. As part of the Circular A-133 compliance audit, the auditor of the pass-through entity should test and report on subrecipient monitoring (which is 1 of the 14 types of compliance requirements in the *OMB Circular A-133 Compliance Supplement [Compliance Supplement]*, as discussed in chapter 10, "Compliance Auditing Applicable to Major Programs," of this guide) when federal awards passed through to subrecipients are material

to a major program (see paragraphs 12.24–.35). If the federal awards provided are immaterial to a major program or relate to a program that is not considered major, the auditor of the pass-through entity has no additional compliance auditing responsibilities related to the funds passed through to subrecipients.

12.07 Most of this chapter focuses on compliance auditing considerations for auditors of pass-through entities. However, paragraphs 12.43–.47 provide additional considerations for auditors of subrecipients.

Pass-Through Entities, Subrecipients, and Vendors

Subrecipient Status Versus Vendor Status

12.08 The responsibilities for compliance with federal program requirements and the direct and material compliance requirements² to be tested by the auditor may be significantly different depending on whether the entity is a pass-through entity, subrecipient, or vendor. Section 210 of Circular A-133 provides guidance on distinguishing between a subrecipient and a vendor; paragraphs 12.09–.11 summarize that guidance.

Characteristics Indicative of a Federal Award Received by a Subrecipient

12.09 According to Circular A-133, characteristics indicative of a federal award received by a subrecipient are when the entity

- determines who is eligible to receive what federal financial assistance;
- has its performance measured against whether the objectives of the federal program are met;
- has responsibility for programmatic decision making;
- has responsibility for adherence to compliance requirements applicable to the federal program; and
- uses the federal funds to carry out a program of the entity as compared to providing goods or services for a program of the pass-through entity.

Paragraph 12.12 provides examples of the relationship between pass-through entities and subrecipients.

Characteristics Indicative of a Payment for Goods or Services Received by a Vendor

12.10 According to Circular A-133, the characteristics indicative of a payment for goods or services received by a vendor are when the entity

² Statement on Auditing Standards (SAS) No. 117, *Compliance Audits* (AICPA, *Professional Standards*, vol. 1, AU sec. 801), defines *applicable compliance requirements* as the compliance requirements that are subject to the compliance audit. Paragraph .500(d) of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133), states that the auditor should determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that may have a direct and material effect on each of its major programs. Therefore, in a Circular A-133 compliance audit, the direct and material compliance requirements are those that are subject to audit. Accordingly, for the purpose of adapting SAS No. 117 to a Circular A-133 compliance audit, the term *applicable compliance requirements* has been replaced by *direct and material compliance requirements* in this guide except when directly citing content from SAS No. 117.

- provides the goods and services within normal business operations;
- provides similar goods or services to many different purchasers;
- operates in a competitive environment;
- provides goods or services that are ancillary to the operation of the federal program; and
- is not subject to the compliance requirements of the federal program.

Paragraph 12.13 provides examples of the relationship between pass-through entities and vendors.

Use of Judgment in Determining Subrecipient or Vendor Status

12.11 Circular A-133 states that there may be unusual circumstances or exceptions to the characteristics listed in paragraphs 12.09–.10. In making the determination of whether a subrecipient or vendor relationship exists, the substance of the relationship is more important than the form of the agreement. It is not expected that all of the characteristics will be present, and judgment should be used in determining whether an entity is a subrecipient or vendor. In some cases, it may be difficult to determine whether the relationship with the entity is that of a subrecipient or of a vendor. The federal cognizant agency for audit, the oversight agency for audit, or the federal awarding agency may be of assistance in making those determinations.

Description of Relationships

Pass-Through Entity and Subrecipient

12.12 Following are examples of a typical relationship between a pass-through entity and a subrecipient:

- A state department of education (pass-through entity) receives a federal award and is responsible for administering and disbursing the federal award to local school districts (subrecipients) according to a formula or on some other basis.
- A regional planning commission (pass-through entity) receives a federal award for the feeding of elderly and low-income individuals, and the award is disbursed to NFPs (subrecipients) to support their feeding programs.
- A university (pass-through entity) receives a federal award, and the award is disbursed to a governmental hospital (subrecipient) to conduct research.
- A state arts commission (pass-through entity) receives a federal award, and the award is disbursed to an NFP theater group (subrecipient) to support a summer arts series.

Recipient and Vendor

12.13 Following are examples of a typical relationship between a recipient and a vendor:

- A local government (recipient) receives a federal award to provide mental health services in a designated area. Some of the funds are paid to a contractor (vendor) to repair a leaking roof.

- A county (recipient) receives a federal award to operate a Head Start program and pays an NFP (vendor) to provide temporary clerical services.
- An NFP (recipient) receives a federal award to run a preschool and pays a medical doctor (vendor) to perform health screening on a per-student basis.
- An NFP (recipient) receives a federal award to operate a child care center and pays a not-for-profit clinic (vendor) to perform physical exams.

Entity Is Both a Subrecipient and a Pass-Through Entity

12.14 Instances occur in which an entity can be both a subrecipient and a pass-through entity, as shown in the following examples:

- A local government receives a pass-through federal award from a state government agency (the local government is a subrecipient) and further passes through a portion of the federal award to an NFP (the local government also is a pass-through entity) to administer a federal program.
- An NFP area agency receives a pass-through federal award from a state (the NFP area agency is a subrecipient) and further passes through a portion of the federal award to a for-profit health care provider (the NFP area agency also is a pass-through entity). Paragraph 12.40 discusses a pass-through entity's responsibilities when the subrecipient is a for-profit entity.

Vendor Compliance Considerations

Auditee's Responsibilities

12.15 Circular A-133 states that in most cases, the auditee's compliance responsibility for a vendor is to ensure only that the procurement, receipt, and payment for goods and services comply with laws, regulations, and the provisions of contracts or grant agreements. A program's compliance requirements normally do not pass through to vendors. However, the auditee is responsible for ensuring compliance for vendor transactions which are structured such that the vendor is responsible for program compliance or the vendor's records must be reviewed to determine compliance.

Auditor's Responsibilities

12.16 When vendors are responsible for program compliance, the auditor should determine whether vendor transactions are in compliance with laws, regulations, and the provisions of contracts or grant agreements if such transactions are material to a major program of the auditee. In such a case, the auditor would normally evaluate a vendor's compliance by reviewing the auditee's records and the results of the auditee's procedures for ensuring compliance by the vendor. When the auditor cannot obtain sufficient assurance of compliance from reviewing the auditee's records and procedures, a deficiency in internal control over compliance exists. The auditor should evaluate the severity of each deficiency in internal control over compliance identified during the audit to determine whether the deficiency, individually or in combination, is a significant deficiency or material weakness in internal control over compliance. The auditor also should perform additional procedures to determine compliance. These

procedures may include testing the vendor's records or obtaining reports on compliance procedures performed by the vendor's independent auditor.

12.17 Prior to performing a single or program-specific audit, it is important for the auditor to understand the nature of the auditee's vendor relationships, whether the vendors are responsible for program compliance, the auditee's procedures for ensuring vendor compliance, and whether it will be necessary for the auditor to test vendor records. Because the amount and type of work done by the auditor may be impacted by the nature of the auditee's relationships with its vendors, it may be appropriate to include in the communication used to establish an understanding with the auditee information related to the auditee's vendors and the effect on the audit, particularly if vendors are responsible for program compliance. (Chapter 6, "Planning Considerations of Circular A-133," of this guide discusses establishing an understanding with the auditee.) If subsequent to undertaking a single or program-specific audit the auditor becomes aware of a significant vendor relationship that will require the auditor to perform additional procedures on vendor records, the auditor should inform the auditee that the requirements of Circular A-133 will not be met unless additional procedures are performed. If the auditee or vendor precludes the auditor from performing such additional procedures, the auditor should qualify his or her opinion or disclaim an opinion because of a scope limitation. (Chapter 13, "Auditor Reporting Requirements and Other Communication Considerations in a Single Audit," of this guide further discusses scope limitations.)

Single Audit Considerations of Pass-Through Entities

12.18 The following matters are relevant to planning and conducting a single audit of a pass-through entity, and discussed in the rest of this section:

- Pass-through entity responsibilities
- Audit planning considerations
- Consideration of internal control over compliance
- Subrecipient monitoring
- Reporting considerations
- For-profit subrecipients
- Non-U.S.-based entities
- A state's designation of a cluster of programs

Pass-Through Entity Responsibilities

12.19 A pass-through entity is responsible for ensuring that subrecipients expend awards in accordance with applicable laws, regulations, and provisions of contracts or grants. Circular A-133 states that a pass-through entity should perform the following for the federal awards it provides to subrecipients:

- Identify the federal awards made by informing each subrecipient of the Catalog of Federal Domestic Assistance (CFDA) title and number, the award's name and number, the award year, whether the award is for research and development, and the name of the federal agency. When some of this information is not available, the pass-through entity should provide the best information available to describe the federal award.

- Advise subrecipients of the requirements imposed on them by federal laws, regulations, and the provisions of contracts or grant agreements, as well as any supplemental requirements imposed by the pass-through entity.
- Monitor the activities of subrecipients as necessary to ensure that federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.
- Ensure that subrecipients expending \$500,000 or more in federal awards during the subrecipient's fiscal year have met the audit requirements of Circular A-133 for that fiscal year.
- Issue management decisions on audit findings within six months after receipt of subrecipients' audit reports, and ensure that subrecipients take appropriate and timely corrective action.
- Consider whether subrecipient audits necessitate the adjustment of the pass-through entity's own records.
- Require subrecipients to permit the pass-through entity and auditors to have access to the records and financial statements as necessary for the pass-through entity to comply with Circular A-133.
- Keep subrecipients' report submissions (or other written notification when the subrecipient is not required to submit a reporting package) on file for three years from the date of receipt. (See the further discussion in paragraph 12.47.)

Audit Planning Considerations

Effect of Pass-Through Federal Awards on the Determination of Major Programs

12.20 As noted in paragraph 12.04, the determination of when a federal award is expended is based on when the activity related to the award occurs. With respect to federal awards provided by a pass-through entity to subrecipients, the federal awards are deemed to be expended by the pass-through entity when the funds are disbursed to subrecipients, regardless of when subrecipients expend the federal funds. Accordingly, the amount of federal funds disbursed to subrecipients should be included in the total expenditures of federal awards of the pass-through entity and in the determination of the pass-through entity's major programs. (Chapter 8, "Determination of Major Programs," of this guide discusses the determination of major programs.)

Pass-Through Entity Request for a Program to Be Audited as a Major Program

12.21 When a subrecipient expends \$500,000 or more of federal awards, Circular A-133 permits the pass-through entity to request that the program be audited as a major program in lieu of the pass-through entity conducting or arranging for additional audits. If the pass-through entity makes such a request, it should pay the full incremental cost for such an audit. (Chapters 5, "Overview of the Single Audit Act, Circular A-133, and the *Compliance Supplement*," and 8 of this guide provide additional information.)

Materiality

12.22 The auditor's consideration of materiality is a matter of professional judgment and is influenced by the auditor's perception of the needs of a reasonable person who will rely upon the auditor's work. A comparison of the amount of federal funds passed through to subrecipients with the total amount of expenditures for each individual major program or cluster can assist the auditor in determining if the pass-through amount is material. When the amount of federal funds passed through to subrecipients is material either quantitatively or qualitatively, in relation to the major program being audited, the need is greater for the auditor to test the subrecipient monitoring requirements. Some federal programs are designed in such a manner that subrecipient expenditures are intended to be material to the pass-through entity's award. For example, the Community Services Block Grant requires a state to subgrant at least 90 percent of the state's award.

Consideration of Internal Control Over Compliance

12.23 As part of performing procedures to obtain an understanding of internal control over compliance for federal programs that is sufficient to plan the audit of the pass-through entity to support a low assessed level of control risk of noncompliance for major programs, the auditor should consider the pass-through entity's internal control over compliance used to monitor subrecipients. (See chapter 9, "Consideration of Internal Control Over Compliance for Major Programs," of this guide.) Tests of internal control over compliance used to monitor subrecipients may include inquiry, observation and inspection of documentation, or a reperformance by the auditor of some or all of the monitoring procedures identified in paragraph 12.28. The nature and extent of the tests performed will vary depending on the auditor's assessment of inherent risk of noncompliance, understanding of the internal control over compliance, materiality, and professional judgment.³ Part 6 of the *Compliance Supplement*, which is available to assist the auditor in evaluating internal control over compliance, describes (among other things) certain characteristics of internal control over compliance that, when present and operating effectively, may ensure compliance with program requirements for subrecipient monitoring. The results of the auditor's testing of internal control over compliance assist in determining the nature, timing, and extent of subrecipient monitoring compliance testing.

Subrecipient Monitoring

12.24 The Single Audit Act Amendments of 1996 requires the pass-through entity to monitor subrecipients' use of federal awards through site visits, limited scope audits, or other means. Because the pass-through entity is held accountable for federal awards administered by its subrecipients, the pass-through entity needs to establish an appropriate subrecipient monitoring process and to decide what, if any, additional monitoring procedures may be necessary to ensure the subrecipients' compliance. Generally, arrangements for subrecipient monitoring and clarification of the compliance requirements applicable to federal awards passed through are made by the pass-through entity in its agreements with subrecipients.

³ In a compliance audit under Circular A-133, controls that address the risks of noncompliance with direct and material types of compliance requirements for major programs should be tested every year. See the section titled "Performing Tests to Evaluate the Effectiveness of Controls" in chapter 9, "Consideration of Internal Control Over Compliance for Major Programs," of this guide for more information.

12.25 Auditors should consider subrecipient monitoring in a Circular A-133 compliance audit of an entity that disburses to subrecipients federal awards that are material to a major program. (Paragraph 12.22 discusses materiality.) The auditor should consider whether the pass-through entity monitors subrecipients and has established internal control over compliance that provides reasonable assurance that subrecipients are managing federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of the pass-through entity's major programs.

Compliance Supplement Guidance

12.26 Subrecipient monitoring is 1 of the 14 types of compliance requirements included in the *Compliance Supplement*. The *Compliance Supplement* identifies several audit objectives for subrecipient monitoring. According to the *Compliance Supplement*, in a Circular A-133 compliance audit of a pass-through entity, the auditor should obtain an understanding of internal control, assess risk, and test internal control as required by the circular, and determine whether the pass-through entity

- properly identified federal award information and compliance requirements to the subrecipient, and approved only allowable activities in the award documents.
- monitored subrecipient activities to provide reasonable assurance that the subrecipient administers federal awards in compliance with federal requirements.
- ensured that the required audits were performed, issued a management decision on audit findings within six months after receipt of the subrecipient's audit report, and ensured that the subrecipient took timely and appropriate corrective action on all audit findings.
- took appropriate action using sanctions in cases of continued inability or unwillingness of a subrecipient to have the required audits.
- evaluated the effect of subrecipient activities on the pass-through entity.

12.27 As discussed in chapter 10 of this guide, the *Compliance Supplement* also identifies the suggested audit procedures for testing the Circular A-133 compliance audit objectives for pass-through entities. The auditor may consider coordinating the subrecipient-related tests performed as part of *cash management* (tests of cash reports submitted by subrecipients), *eligibility* (tests that subawards were made only to eligible subrecipients), and *procurement* (tests of suspension and debarment certifications) with the tests of subrecipient monitoring.

Pass-Through Entity Monitoring Procedures

12.28 Part 3 of the *Compliance Supplement* discusses the pass-through entity's subrecipient monitoring responsibilities and activities. The monitoring procedures that a pass-through entity may use include on-site visits, reviews of financial and performance reports submitted by the subrecipient, regular contacts with subrecipients and appropriate inquiries concerning program activities, and limited-scope audits. Limited-scope audits are agreed-upon

procedures engagements that are conducted in accordance with the AICPA attestation standards. *Limited-scope audits* are both arranged and paid for by a pass-through entity and only address one or more of the following types of compliance requirements: activities allowed or unallowed; allowable costs or cost principles; eligibility; matching, level of effort, and earmarking; and reporting. The following procedures are other monitoring activities that a pass-through entity may perform:

- Reviewing grant applications submitted by subrecipients to determine that
 - applications are filed and approved in a timely manner; and
 - each application contains the condition that the subrecipient comply with the federal requirements set by the federal agency.
- Establishing that internal control over compliance provides reasonable assurance that
 - funds are disbursed to subrecipients only on an as-needed basis;
 - funds are disbursed to subrecipients only on the basis of approved, properly completed reports submitted on a timely basis;
 - refunds that are due from subrecipients are billed and collected in a timely manner; and
 - subrecipients and other entities and individuals receiving federal funds meet eligibility requirements.
- Reviewing financial and technical reports received from subrecipients on a timely basis and investigating unusual items.
- Reviewing subrecipient audit reports to evaluate them for completeness and for compliance with applicable laws and regulations.
- Evaluating audit findings; issuing appropriate management decisions, if necessary; and determining if an acceptable plan for corrective action has been prepared and implemented.
- Reviewing previously detected deficiencies and determining that corrective action was taken.

Monitoring When the Subrecipient Has a Single or Program-Specific Audit

12.29 As noted in paragraph 12.03, subrecipients that expend \$500,000 or more in federal awards should have a single or program-specific audit in accordance with Circular A-133. If subrecipients have a single or program-specific audit, the pass-through entity's receipt and review of the results of that audit and its action on related findings may be sufficient to meet the subrecipient monitoring requirements of Circular A-133.⁴ However, it is more likely that the

⁴ As discussed in paragraph 12.47, a subrecipient is not required to submit its reporting package to the pass-through entity when it has no audit findings or the summary schedule of prior audit findings does not report the status of any audit findings. The *OMB Circular A-133 Compliance* (continued)

receipt and review of such audit results is only 1 tool used by the pass-through entity as part of a comprehensive subrecipient-monitoring process. This is because a single audit is likely to provide varying degrees of assurance concerning a particular program. For example, a pass-through award may not have been tested as a major program as part of a subrecipient's audit. For this reason, the pass-through entity should consider the testing and results of the single audit of the subrecipient to determine what effect those results should have on other monitoring procedures employed by the pass-through entity.

12.30 In many cases, the pass-through entity will not have received all the subrecipient audit reports covering the time period being audited at the pass-through entity in time to incorporate the results into its own audit. The reports for the pass-through entity and the subrecipient are not required to be issued simultaneously, but the pass-through entity should have internal control over compliance in place to determine that (a) subrecipient audit reports have been received, and (b) corrective action is taken after the receipt of the subrecipient's audit. If the subrecipient's audit report is current, it need not cover the same period as the pass-through entity's audit. If the pass-through entity has an effective system for monitoring subrecipients, its auditor would be more likely to rely on the subrecipient's audit cycle, even if it does not coincide with the pass-through entity's fiscal year.

Considering Risk Factors When Developing Monitoring Procedures

12.31 The *Compliance Supplement* states that the OMB expects pass-through entities to consider various risk factors (such as the relative size and complexity of the federal awards administered by subrecipients and other subrecipient risks including the entity's prior experience with each subrecipient) in developing the nature, timing, and extent of subrecipient monitoring procedures. Consider, for example, a pass-through entity that provides a large percentage of the only federal award it expends to 10 subrecipients that each expends less than \$500,000 in federal awards annually. Careful consideration by the pass-through entity of the most effective method of monitoring these federal awards is needed. Perhaps a significant majority of this federal award is provided to 2 of the subrecipients. If so, the pass-through entity might consider conducting site visits at the 2 subrecipients that received a significant majority of the federal award and simply reviewing the documentation supporting requests for reimbursement from the other 8 subrecipients. Conversely, if a small percentage of a federal award is provided to subrecipients that each expends less than \$500,000 in federal awards, the risk to the pass-through entity is most likely low and, therefore, the monitoring procedures could be minimal.

Unallowable Audit Costs

12.32 For subrecipients that expend less than \$500,000 in federal awards annually, the cost of any audits or attestation engagements (other than the

(footnote continued)

Supplement (Compliance Supplement) suggests that in these situations a pass-through entity may use the information in the Federal Audit Clearinghouse (FAC) database (available at the FAC website at <http://harvester.census.gov/sac>) as evidence to verify that the subrecipient had "no audit findings" and that the required audit was performed. In a case where the subrecipient is not required to submit its reporting package to the pass-through entity, the pass-through entity may request a copy of the reporting package from the subrecipient.

limited-scope audits paid for and arranged by a pass-through entity as described in paragraph 12.28), are not allowable costs and, therefore, cannot be charged to any federal award. Accordingly, Circular A-133 would prohibit the cost of a financial statement audit conducted in accordance with generally accepted auditing standards or *Government Auditing Standards* from being charged (by either a pass-through entity or subrecipient) to federal awards for a subrecipient that expends less than \$500,000 in federal awards annually. Chapter 5 of this guide discusses the allowability of audit costs in greater detail.

When the Subrecipient Monitoring System Is Not Sufficient

12.33 The auditor may determine that the pass-through entity's subrecipient-monitoring system is not sufficient to ensure the subrecipient's compliance with laws, regulations, and the provisions of grants and contracts. In this situation, the auditor should report a significant deficiency in internal control over compliance (and possibly a material weakness in internal control over compliance) and consider whether the insufficient monitoring system represents an instance of noncompliance that should be reported as a compliance finding (which is likely to be the case). The effect of the noncompliance on the opinion on compliance for major programs is primarily a function of the pervasiveness of the lack of monitoring and the materiality of subrecipient funding to a program. For example, if the pass-through entity did not perform subrecipient-monitoring procedures and 90 percent of the program was passed through to subrecipients, an opinion modification would likely be warranted. This would likely be the case even if the scope of the audit was expanded to include additional audit procedures to determine that the subrecipients actually complied with laws and regulations.

12.34 Instances may occur in which the pass-through entity asks the auditor to perform additional procedures to determine the compliance of a subrecipient with direct and material types of compliance requirements (such as conducting tests of records at the subrecipient's site). This would be considered an expansion of the scope of the audit. This expansion of the scope of the audit would not be sufficient to remedy the significant deficiency (or material weakness) and, if applicable, noncompliance of the pass-through entity's monitoring system. However, an expansion of the scope of the audit may remedy the noncompliance related to the type of compliance requirement being tested (for example, eligibility).

12.35 The auditor also should consider any implications of an insufficient subrecipient-monitoring system on the opinion on the financial statements. If amounts passed through to subrecipients are considered material to the financial statements of the pass-through entity, the auditor should determine whether the report on the financial statements should be modified. Factors to consider in making such a determination include any audit evidence available to the auditor (such as subrecipients' Circular A-133 audit reports and other financial reports that may have been submitted to the pass-through entity) that could indicate that the subrecipients administered the program in compliance with laws and regulations. Further, the auditor also should consider whether it is necessary to report an internal control or compliance finding in the report issued to meet the requirements of *Government Auditing Standards*.

Reporting Considerations⁵

Schedule of Expenditures of Federal Awards

12.36 Circular A-133 states that, to the extent practical, pass-through entities should identify in the schedule of expenditures of federal awards the total amount provided to subrecipients from each federal program. (Chapter 7, "Schedule of Expenditures of Federal Awards," of this guide discusses the schedule.) If a pass-through entity is unable to identify amounts provided to subrecipients, the auditor should consider whether a significant deficiency in internal control over compliance (and possibly a material weakness in internal control over compliance) should be reported. The auditor also should consider whether material noncompliance (for subrecipient monitoring) has occurred, which should be reported as an audit finding.

Evaluation of Audit Findings

12.37 Circular A-133 requires the auditor to consider a finding in relation to the type of compliance requirement (subrecipient monitoring, in this case) or an audit objective identified in the *Compliance Supplement*, whether or not the finding can be quantified. For example, the auditor may discover that a pass-through entity consistently failed to provide its subrecipients with federal award information, including the compliance requirements applicable to the federal program. The pertinent audit objective included in the *Compliance Supplement* and relating to this example is for the auditor to "determine whether the pass-through entity identifies federal award information and compliance requirements to the subrecipient." Because the pass-through entity failed to provide federal award information to its subrecipients, this noncompliance is material in relation to the audit objective and, therefore, should be reported as an audit finding. In addition, the auditor should consider whether significant deficiencies in internal control over compliance (and possibly, material weaknesses in internal control over compliance) exist and require reporting with respect to subrecipient monitoring.⁶

Effect of Subrecipients' Noncompliance on the Pass-Through Entity's Report

12.38 The instances of noncompliance reported in subrecipients' audit reports are not required to be included in the pass-through entity's audit report. However, as noted previously, the auditor of the pass-through entity should consider the effects of reported instances of subrecipient noncompliance or indications of weaknesses in the pass-through entity's subrecipient-monitoring system that could have a material effect on each of the pass-through entity's major programs.

⁵ Certain laws and regulations may require audit reports to be made publicly available, therefore the auditor is cautioned not to include names, Social Security numbers, other personal identification, or other potentially sensitive information in the body of audit reports or any attached or referenced schedules or letters.

⁶ Chapters 4, "Auditor Reporting Requirements and Other Communication Considerations of *Government Auditing Standards*," and 13, "Auditor Reporting Requirements and Other Communication Considerations in a Single Audit," of this guide discuss the *Government Auditing Standards* requirement that the auditor communicate certain matters to the auditee in a written communication (commonly a management letter).

Adjustment of Pass-Through Entity Financial Records and Reports

12.39 Questioned costs at the subrecipient level that are found to be unallowable by the pass-through entity may require the pass-through entity to adjust its financial records and its federal expenditure reports. The total of allowable program costs in excess of required expenditure levels and the requirements of individual programs regarding the timing of claims will affect whether the pass-through entity will need to reflect a liability to the awarding agency in its financial statements. As part of the finding-resolution process, the pass-through entity should estimate the total unallowable costs that are associated with each subrecipient finding and consider the need to adjust financial records and federal expenditure reports. The failure of the pass-through entity to adjust its records and federal reports should be considered by the auditor in forming an opinion on compliance for major programs.

For-Profit Subrecipients

12.40 Because Circular A-133 does not apply to for-profit subrecipients, the pass-through entity is responsible for establishing requirements, as necessary, to ensure compliance by for-profit subrecipients. Circular A-133 states that the contract with the for-profit subrecipient should describe compliance requirements applicable to a federal program and the for-profit subrecipient's compliance responsibility. Methods to ensure compliance for federal awards made to for-profit subrecipients may include preaward audits, monitoring during the contract, and postaward audits. The auditor's responsibilities related to for-profit subrecipients are similar to those of not-for-profit subrecipients; see paragraphs 12.24–.35 (as applicable) for a further discussion of subrecipient monitoring.

Non-U.S.-Based Entities

12.41 As discussed in chapter 5 of this guide, Circular A-133 does not apply to non-U.S.-based entities expending federal awards received either directly as a recipient or indirectly as a subrecipient. Therefore, the responsibilities that a pass-through entity and its auditor have for a non-U.S.-based entity are the same as those for a for-profit subrecipient (see paragraph 12.40).

State Designation of a Cluster of Programs

12.42 Circular A-133 includes a provision that allows a state to designate as a cluster a grouping of closely related programs that share common compliance requirements. When designating a cluster of programs, a state should identify the federal awards included in the cluster and to advise subrecipients of the compliance requirements applicable to the cluster. (Chapter 5 of this guide discusses clusters of programs.)

Circular A-133 Audit Considerations of Subrecipients

12.43 Subrecipients may have additional audit considerations under Circular A-133 that their auditors may need to address. These considerations, as discussed in this section, concern (a) additional compliance requirements that may be established by the pass-through entity, (b) information included in the schedule of expenditures of federal awards, (c) audit findings, and (d) the submission of the report.

Additional Compliance Requirements Established by Pass-Through Entities

12.44 Federal awards normally are distributed to subrecipients only on the basis of properly completed and approved awards. These written agreements require subrecipients to comply with the requirements of the federal agency and, in some instances, additional requirements established by the pass-through entity. Hence, in addition to providing an audit satisfying the requirements of Circular A-133, the auditor may be engaged to test compliance with requirements specified by the pass-through entity.

Information Included in the Schedule of Expenditures of Federal Awards

12.45 For federal awards received as a subrecipient, Circular A-133 states that the schedule of expenditures of federal awards should include the name of the pass-through entity and identifying number assigned by the pass-through entity. Circular A-133 states that, to make the schedule easier to use, subrecipients may choose to provide information requested by federal awarding agencies and pass-through entities, although this information is not required. Chapter 7 of this guide discusses the schedule.

Audit Findings

12.46 Audit findings (for example, internal control findings, compliance findings, questioned costs, or fraud) that relate to the same issue should be presented as one audit finding. Circular A-133 states that where practical, audit findings should be organized by federal agency or pass-through entity. (Chapter 13 of this guide discusses audit findings).

Submission of the Report

12.47 Section 320(e) of Circular A-133 has additional report-submission responsibilities for subrecipients. When a subrecipient is not required to submit a reporting package to the pass-through entity (because for the pass-through entity's programs the subrecipient has no audit findings and the summary schedule of prior audit findings does not report the status of any audit findings), the subrecipient should provide written notification of this to the pass-through entity. As an alternative, a reporting package may be submitted to the pass-through entity. Chapter 13 of this guide discusses the required contents of the written notification and the submission of the report by subrecipients.

American Recovery and Reinvestment Act Considerations*

12.48 The receipt and expenditure of Recovery Act funding imposes additional requirements on pass-through entities. Some of those additional requirements are that the pass-through entity must

* Information in this guide related to the American Recovery and Reinvestment Act of 2009 (Recovery Act) is based upon the latest information available at the time of this writing. However, this information is subject to change because guidance from OMB is being issued and updated on an ongoing basis. It is important that recipients of Recovery Act funding, and their auditors, monitor the guidance issued. For the latest OMB guidance, go to the OMB website at www.whitehouse.gov/omb/recovery_default. Information can also be found at the Recovery Act Resource Center on the Governmental Audit Quality Center website, which is open to the public at www.aicpa.org/INTERESTAREAS/GOVERNMENTALAUDITQUALITY/RESOURCES/RECOVERYACTRESOURCECENTER/Pages/default.aspx and at the U.S. Government's official Recovery Act website at www.recovery.gov.

- identify to each subrecipient through documentation at the time of subaward and disbursement of funds, the federal award number, CFDA number and amount of Recovery Act funds and
- require subrecipients to provide separate identification of Recovery Act awards in their Schedule of Expenditures of Federal Awards (SEFA) and in Form SF-SAC.

The *Compliance Supplement*[†] clarifies that the responsibilities listed in the preceding list apply to recipients informing "first tier" subrecipients or those recipients that receive an award directly from the recipient. These responsibilities to separately identify and require separate presentation on the SEFA may not have been included in the terms and conditions in grant agreements for awards made by first tier subrecipients and below. However, where the funding was through a Recovery Act specific CFDA number or where a subrecipient chose to separately identify the grant as having Recovery Act funding, the subrecipient should separately present the Recovery Act funding on their SEFA.

[†] At the time of this writing, the *Compliance Supplement* is expected to include the information contained in this section. It is important that readers be alert to final issuance of the *Compliance Supplement*, which will be available on the OMB website at www.whitehouse.gov/omb/grants_circulars/.

Chapter 13

Auditor Reporting Requirements and Other Communication Considerations in a Single Audit

Note: The audit required by the Single Audit Act Amendments of 1996 and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133), should be performed in accordance with *Government Auditing Standards*. Part I, "Government Auditing Standards Audits," (chapters 2–4 of this guide) discusses financial statement audits under generally accepted auditing standards and *Government Auditing Standards*. The guidance in parts I and II, "Circular A-133 Audits," (chapters 5–14 of this guide) is applicable for those auditors performing an audit under the Single Audit Act Amendments of 1996 and Circular A-133.

Information related to the American Recovery and Reinvestment Act of 2009 (Recovery Act) can be found in a section located at the end of each chapter in part II of this guide. See the section titled "American Recovery and Reinvestment Act Considerations" beginning at paragraph 13.54 in this chapter. See also the preface section titled "Impact of the American Recovery and Reinvestment Act of 2009 on Single Audits."

Overview

13.01 This chapter discusses the auditor's reporting requirements and other communication considerations in a single audit under Circular A-133. It also provides illustrative auditor's reports in appendix A (paragraph 13.56). (Chapter 14, "Program-Specific Audits," discusses the auditor's reporting requirements in and provides illustrative reports for a program-specific audit.)

13.02 The auditor's reporting responsibilities in a single audit are driven by the three levels of auditing standards and requirements: generally accepted auditing standards (GAAS), *Government Auditing Standards*, and Circular A-133. These standards and requirements expand the level of auditor responsibility from reporting on an auditee's financial statements to also reporting on internal control and on compliance. The auditor has additional reporting responsibilities for the audit of the financial statements in accordance with *Government Auditing Standards* (see chapter 4, "Auditor Reporting Requirements and Other Communication Considerations of *Government Auditing Standards*," of this guide), and for the Circular A-133 compliance audit applicable to major programs (see chapter 8, "Determination of Major Programs," chapter 9, "Consideration of Internal Control Over Compliance for Major Programs," and chapter 10, "Compliance Auditing Applicable to Major Programs," of this guide.) The auditor also has certain additional communication considerations under GAAS and *Government Auditing Standards* related to internal control, fraud,

illegal acts, violations of contracts or grant agreements, abuse, and other matters identified in the audit as discussed in this chapter and in chapter 4 of this guide.

Circular A-133 Requirements

Auditor's Reports

13.03 Circular A-133 states that the auditor's report(s) should include the following:

- An opinion (or disclaimer of opinion)¹ on whether the financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles (GAAP) (paragraph 13.09 discusses basis of accounting) and an opinion (or a disclaimer of opinion) on whether the schedule of expenditures of federal awards is presented fairly in all material respects in relation to the financial statements taken as a whole.
- A report on the internal control related to the financial statements and on the internal control related to major programs. This report should describe the scope of testing of internal control and the results of the tests and, where applicable, refer to the separate schedule of findings and questioned costs.
- A report on compliance with laws, regulations, and the provisions of contracts or grant agreements (hereinafter referred to as *compliance requirements*), noncompliance that could have a material effect on the financial statements. This report also should include an opinion (or a disclaimer of opinion) on whether the auditee complied with laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on each major program, and where applicable, refer to the separate schedule of findings and questioned costs.
- A schedule of findings and questioned costs.

Paragraphs 13.06–.08 describe the auditor's reports recommended in this guide.

Data Collection Form

13.04 Circular A-133 also states that the auditor should complete applicable sections of a data collection form (DCF) that summarizes the auditor's results, findings, and questioned costs. This form is required to be submitted to the Federal Audit Clearinghouse (FAC) by the auditee. (See paragraphs 13.46–.52.)

Reporting Package

13.05 The auditee should submit a reporting package (as part of the DCF submission) that includes the following:

¹ As explained in the AICPA Audit and Accounting Guide *State and Local Governments*, the auditor generally expresses or disclaims an opinion on a government's basic financial statements by providing an opinion or disclaimer of opinion on each opinion unit required to be presented in those financial statements. In addition, the auditor may provide opinions or disclaimers of opinions on additional opinion units if engaged to set the scope of the audit and assess materiality at a more detailed level than by the opinion units required for the basic financial statements. Throughout this guide, the use of the singular terms *opinion* and *disclaimer of opinion* encompasses the multiple opinions and disclaimers of opinion that generally will be provided on a government's financial statements.

- Financial statements and a supplementary schedule of expenditures of federal awards (see chapter 7, "Schedule of Expenditures of Federal Awards," of this guide)
- Auditor's reports (see paragraphs 13.06–.08)
- A summary schedule of prior audit findings (see paragraphs 13.41–.42)
- A corrective action plan (see paragraphs 13.43–.45)

Recommended Auditor's Reports

13.06 Reporting on a financial statement audit and on the compliance requirements that could have a direct and material ² effect on each major program involves varying levels of materiality and different forms of reporting. Circular A-133 states that the auditor's report(s) may be in the form of either combined or separate reports and may be organized differently from the manner presented in the circular. In an effort to make the reports understandable and to reduce the number of reports issued, this guide recommends that the following reports be issued:

- a. A report on the financial statements and on the supplementary schedule of expenditures of federal awards³ (see paragraphs 13.09–.14)
- b. A report on internal control over financial reporting⁴ and on compliance and other matters based on an audit of financial statements performed in accordance with *Government Auditing Standards* (see paragraphs 13.15–.16)
- c. A report on compliance with requirements that could have a direct and material effect on each major program and on internal control over compliance⁵ in accordance with Circular A-133 (see paragraphs 13.18–.24)
- d. A schedule of findings and questioned costs (see paragraphs 13.33–.42)

13.07 Appendix A in chapter 4 of this guide and appendix A (paragraph 13.52) in this chapter present illustrative auditor's reports for single audits.

² Statement on Auditing Standards (SAS) No. 117, *Compliance Audits* (AICPA, *Professional Standards*, vol. 1, AU sec. 801), defines *applicable compliance requirements* as the compliance requirements that are subject to the compliance audit. Section 500(d) of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133), states that the auditor should determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that may have a direct and material effect on each of its major programs. Therefore, in a Circular A-133 compliance audit, the direct and material compliance requirements are those that are subject to audit. Accordingly, for the purpose of adapting SAS No. 117 to a Circular A-133 compliance audit in this chapter, the term *applicable* has been replaced by *direct and material* when referring to such compliance requirements, except when citing content from SAS No. 117.

³ Note that in certain circumstances the auditor may report on the schedule of expenditures of federal awards in his or her report on compliance with requirements that could have a direct and material effect on each major program and on internal control over compliance in accordance with Circular A-133. See paragraph 13.14 for a further discussion.

⁴ Controls relevant to an audit of the financial statements are referred to collectively in this guide as "internal control over financial reporting" and are encompassed in the reporting on internal control required by *Government Auditing Standards*.

⁵ Controls relevant to an audit of compliance with requirements applicable to major federal programs are referred to collectively in this guide as "internal control over compliance" and are encompassed in the reporting on internal control required by Circular A-133.

As noted previously, those reports combine reports on compliance and internal control at the financial statement audit level and at the major program compliance audit level. Because the reports in appendix A are illustrative, auditors may tailor the reporting based on the auditor's understanding of the intended purpose of the reports and the specific auditee facts and circumstances. Because the reports issued to comply with Circular A-133 involve varying levels of materiality and different forms of reporting, it is necessary to exercise care in issuing reports to ensure that they meet all of the varying reporting requirements of GAAS, *Government Auditing Standards*, and Circular A-133. The basic elements of each of the recommended reports are discussed later in this chapter. Professional judgment may be exercised in any situation not specifically addressed in this guide.

13.08 Table 13-1 provides a matrix depicting the recommended auditor's reports in a single audit required by GAAS, *Government Auditing Standards*, and Circular A-133.

Table 13-1

Recommended Reporting in Single Audits

| Report | GAAS | Required by | |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------|-------------------------------|----------------|
| | | Government Auditing Standards | Circular A-133 |
| Opinion (or disclaimer of opinion) on financial statements and supplementary schedule of expenditures of federal awards | X | X | X |
| Report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements | | X | X |
| Report on compliance and internal control over compliance applicable to <i>each</i> major program (this report includes separate opinions [or disclaimers of opinion] on each major program's compliance) | | | X |
| Schedule of findings and questioned costs | | | X |

Reporting on the Financial Statements and Supplementary Schedule of Expenditures of Federal Awards in Accordance With GAAS and *Government Auditing Standards*

Basis of Accounting

13.09 Circular A-133 does not prescribe the basis of accounting that auditees use to prepare their financial statements or the schedule of expenditures of

federal awards. However, auditees should disclose the bases of accounting and the significant accounting policies used in preparing the financial statements and the schedule of expenditures of federal awards. Further, as noted in chapter 7 of this guide, a reconciliation of the amounts presented in the financial statements to related amounts in the schedule of expenditures of federal awards will assist the auditee in providing evidence to the auditor regarding the accuracy of the amounts presented. Circular A-133 states that the auditor should issue an opinion (or a disclaimer of opinion) on whether the financial statements are presented fairly in all material respects in conformity with GAAP⁶ and whether the schedule of expenditures of federal awards is presented fairly in all material respects in relation to the auditee's financial statements taken as a whole.

Implementing Regulations of Federal Awarding Agencies May Define the Entity to Be Audited Differently Than Does GAAP

13.10 The regulations implementing Circular A-133 may define the entity to be audited for single audit purposes differently than the reporting entity would be defined in conformity with GAAP. For example, Financial Accounting Standards Board *Accounting Standards Codification* 958–810 requires presentation of consolidated financial statements when one not-for-profit entity (NFP) (the parent) controls the voting majority of the board of and has an economic interest in another NFP. If the regulations of the federal agency that provides federal awards to the parent define the entity for single audit purposes to consist of only the parent, audited parent-only financial statements instead of consolidated financial statements should be submitted to comply with these regulations. If the NFP's consolidated financial statements are not also prepared as required by GAAP, an other than unqualified opinion due to a material departure from GAAP on the parent-only financial statements may be required. Paragraphs .35–.60 of AU section 508, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1), and various AICPA Audit and Accounting Guides, including *Health Care Entities*, *Not-for-Profit Entities*, and *State and Local Governments*, provide guidance on reporting when there is a departure from GAAP.

Report on the Financial Statements and on the Supplementary Schedule of Expenditures of Federal Awards

13.11 Chapter 4 of this guide describes the requirements of the auditor's standard report on the financial statements and on accompanying supplementary information—required supplementary information (RSI) and

⁶ AU section 623, *Special Reports* (AICPA, *Professional Standards*, vol. 1), defines the comprehensive bases of accounting other than generally accepted accounting principles, known as *other comprehensive bases of accounting* (OCBOA), and establishes requirements for reporting on audits of OCBOA financial statements. Interpretation No. 14, "Evaluating the Adequacy of Disclosure and Presentation in Financial Statements Prepared in Conformity With an Other Comprehensive Basis of Accounting (OCBOA)," and No. 15, "Auditor Reports on Regulatory Accounting or Presentation When the Regulated Entity Distributes the Financial Statements to Parties Other Than the Regulatory Agency Either Voluntarily or Upon Specific Request," of AU section 623 (AICPA, *Professional Standards*, vol. 1, AU sec. 9623 par. .90–.98), provide additional guidance on reporting on audits of OCBOA financial statements. The AICPA Audit and Accounting Guide *State and Local Governments* discusses the application of AU section 623 and those interpretations to state and local governmental financial statements. That guide and paragraph .97 of Interpretation No. 15 also provide illustrative auditor's reports on OCBOA financial statements. In addition, in the AICPA's Practice Aid Series, two publications—*Applying OCBOA in State and Local Governmental Financial Statements* and *Preparing and Reporting on Cash- and Tax-Basis Financial Statements*—provide nonauthoritative guidance on preparing and reporting on OCBOA financial statements.

supplementary information other than RSI (known as SI). Appendix A in chapter 4 of this guide illustrates that report. With regard to the schedule of expenditures of federal awards, this guide recommends that the auditor report on that schedule in the report on the financial statements as SI; see illustrative paragraphs for that report in paragraphs 13.12–13.⁷ (See paragraph 13.14 if the schedule does not accompany the financial statements.) Accordingly, the report on the financial statements as it relates to the schedule of expenditures of federal awards should include the following:

- a. An identification of the schedule of expenditures of federal awards as accompanying SI. This identification may be by descriptive title or by page number of the document.
- b. A statement that the audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole (or for the purpose of forming opinions on the financial statements that collectively comprise the basic financial statements of a state or local government), and that the schedule of expenditures of federal awards required by Circular A-133 is presented for purposes of additional analysis and is not a required part of the financial statements.
- c. An opinion on whether the schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

13.12 The following is an illustrative paragraph for the auditor's reporting on the schedule of expenditures of federal awards for a state or local government:

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Example's basic financial statements. The accompanying schedule of expenditures of federal awards⁸ is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.⁹

⁷ AU section 551, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents* (AICPA, *Professional Standards*, vol. 1), and paragraph .07 of AU section 550, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1), provide guidance on such reporting. See footnotes ‡ and || in paragraph 5.05 of this guide for information on recently issued SASs that revise the guidance in AU section 551 and AU section 550 upon its effective date.

⁸ If the auditor is reporting on additional supplementary information (for example, combining and individual nonmajor fund financial statements and schedules), this paragraph should be modified to describe the additional supplementary information. See the illustrative report in appendix A in chapter 4, "Auditor Reporting Requirements and Other Communication Considerations of *Government Auditing Standards*," of this guide as well as the illustrative reports in the AICPA Audit and Accounting Guide *State and Local Governments* and AU section 550.

⁹ When reporting on the supplementary information, the auditor should consider the effect of any modifications to the report on the basic financial statements. (See also paragraph 13.31.) Furthermore, if the report on supplementary information is other than unqualified, this paragraph should be modified. Guidance for reporting in these circumstances is described in paragraphs .09–.11 and .13–.14 of AU section 551.

13.13 The following is an illustrative paragraph for the auditor's reporting on the schedule of expenditures of federal awards for an NFP:

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying schedule of expenditures of federal awards¹⁰ is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.¹¹

13.14 Some entities do not present the schedule of expenditures of federal awards with the financial statements; that is, they issue a separate single audit package. In such a circumstance, the required reporting on the schedule may be incorporated in the report issued to meet the requirements of Circular A-133. Footnotes in the illustrative reports in appendix A (paragraph 13.56), examples 13-1–13-5, illustrate how to incorporate the reporting on the schedule into the Circular A-133 report. See also paragraphs 13.28–.30 for information on dating the reports in that situation.

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With Government Auditing Standards

13.15 As discussed in chapter 4 of this guide, *Government Auditing Standards* states that the auditor should issue a report that describes the scope of the auditor's testing of internal control over financial reporting and compliance with laws, regulations, and provisions of contracts or grant agreements and present the results of those tests. *Government Auditing Standards* also states that the auditor should report, as applicable to the objectives of the audit, (a) significant deficiencies in internal control over financial reporting, (b) instances of fraud and illegal acts¹² unless inconsequential,¹³ (c) material violations of provisions of contracts or grant agreements, and (d) material abuse.

¹⁰ If the auditor is reporting on additional supplementary information (for example, a comparison of actual and budgeted expenses), this paragraph should be modified to describe the additional supplementary information. AU section 551 provides useful guidance.

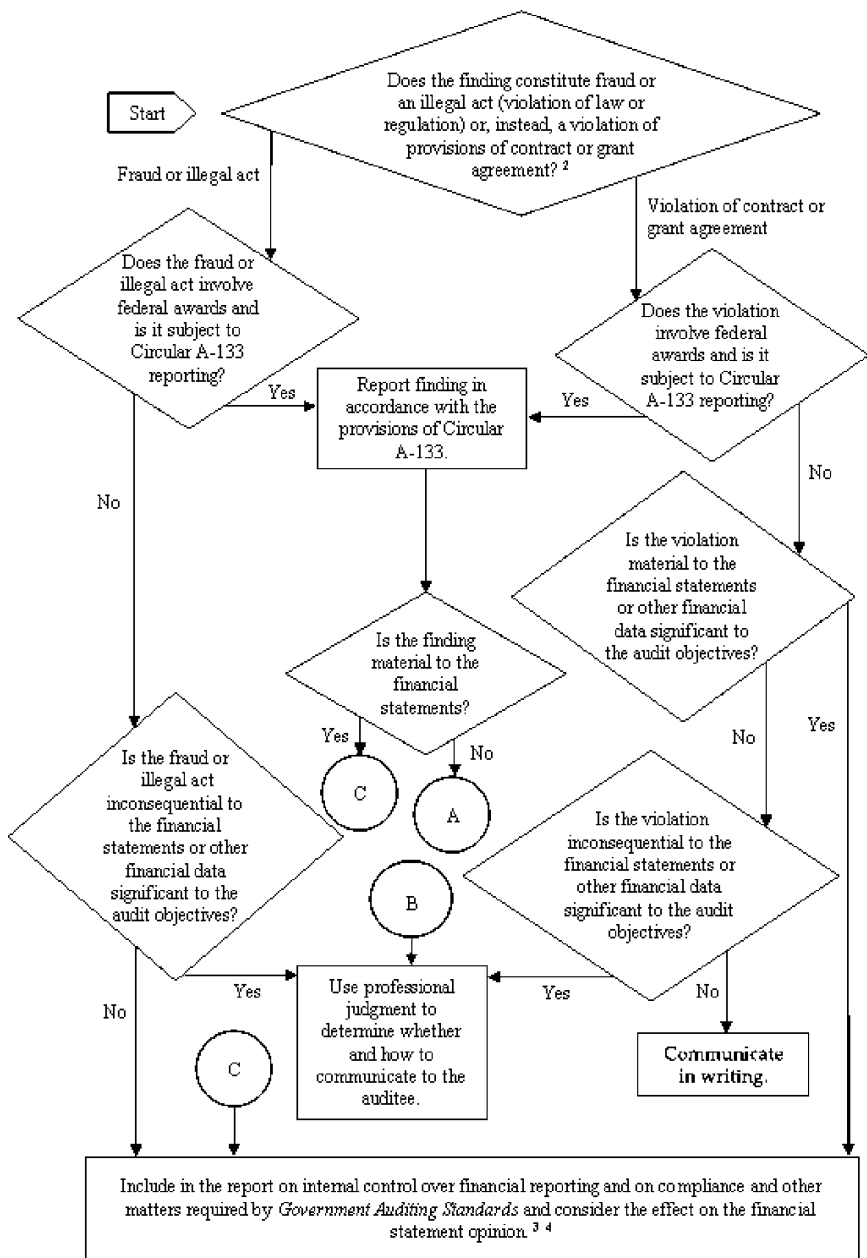
¹¹ See footnote 9.

¹² Paragraph 4.28 of *Government Auditing Standards* and paragraph .02 of AU section 317, *Illegal Acts by Clients* (AICPA, *Professional Standards*, vol. 1), define the term *illegal acts* as violations of laws and regulations. As indicated in chapter 3, "Financial Statement Audit Considerations of *Government Auditing Standards*," of this guide, it generally has been interpreted under generally accepted auditing standards (GAAS) that the term *laws and regulations* in AU section 317 implicitly includes provisions of contracts or grant agreements. This guide sometimes collectively refers to laws, regulations, and provisions of contracts and grant agreements as *compliance requirements* and to illegal acts and violations of provisions of contracts or grant agreements as *noncompliance* or *instances of noncompliance*.

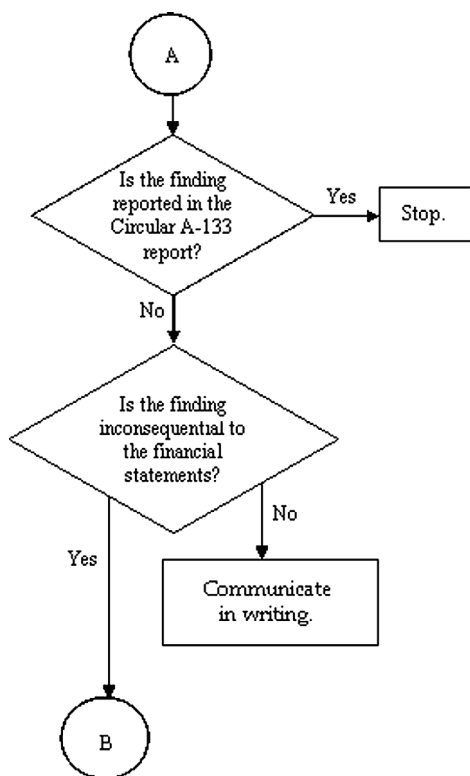
¹³ Footnote 64 in paragraph 5.10 of *Government Auditing Standards* states that if the auditor is performing an audit in accordance with Circular A-133, the circular defines the thresholds for reporting and that those thresholds are sufficient to meet the requirements of *Government Auditing Standards*. Paragraph 13.37 lists the fraud and illegal acts related to federal awards that Circular A-133 requires to be reported.

(Chapter 4 of this guide describes the requirements of the auditor's standard report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with *Government Auditing Standards*. Appendix A [paragraph 4.51] in chapter 4 illustrates that report.) In an audit conducted in accordance with Circular A-133, the auditor should apply a financial statement materiality consideration in reporting in the *Government Auditing Standards* report fraud and illegal acts involving federal awards that are subject to Circular A-133 reporting. That is because those findings already are reported in the Circular A-133 report and reporting findings that are not material to the financial statements again in the *Government Auditing Standards* report would be unnecessarily duplicative. (See paragraph 13.37.)

13.16 Exhibit 13-1 is a flowchart that illustrates the evaluation and reporting of findings of fraud and noncompliance under *Government Auditing Standards* when the auditee is subject to an audit in accordance with Circular A-133 audit. (Chapter 4 of this guide presents a flowchart that illustrates the evaluation and reporting of findings of fraud and noncompliance under *Government Auditing Standards* when the auditee is not subject to an audit in accordance with Circular A-133.) Chapter 3, "Financial Statement Audit Considerations of *Government Auditing Standards*," of this guide includes a flowchart that illustrates its discussion of the evaluation and reporting of findings of abuse.

Exhibit 13-1**Evaluation and Reporting of Findings of Fraud and Noncompliance Under *Government Auditing Standards* and Circular A-133¹**

(continued)



¹ This flowchart represents the evaluation and reporting of findings of fraud and noncompliance (illegal acts and violations of provisions of contracts or grant agreements) under *Government Auditing Standards* when the auditee is subject to an audit in accordance with Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133). In a Circular A-133 audit, the auditor should apply a financial statement materiality consideration in reporting fraud and illegal acts (those that concern the left leg of this flowchart) in reporting in the *Government Auditing Standards* report fraud and illegal acts involving federal awards that are subject to Circular A-133 reporting. That is because those findings already are subject to Circular A-133 reporting and reporting findings that are not material to the financial statements again in the *Government Auditing Standards* report would be unnecessarily duplicative. Chapter 4, "Auditor Reporting Requirements and Other Communication Considerations of Government Auditing Standards," of this guide presents a flowchart that illustrates the evaluation and reporting of findings of fraud and noncompliance when the auditee is subject to an audit in accordance with *Government Auditing Standards*, but not an audit in accordance with Circular A-133.

² The auditor should consider the direct reporting requirement of *Government Auditing Standards*. Chapter 4 of this guide discusses the requirements in paragraphs 5.18–20 of *Government Auditing Standards* that auditors

report fraud and noncompliance directly to parties outside of the auditee in certain circumstances.

- ³ Chapter 4 of this guide discusses (a) how to report noncompliance findings that relate to both internal control over financial reporting and to compliance and (b) when to report fraud findings in the internal control section of the report or instead in the section on compliance and other matters.
 - ⁴ If the finding is reported in both (a) the report on internal control over financial reporting and on compliance and other matters required by *Government Auditing Standards* and (b) the report on compliance with requirements that could have a direct and material effect on each major program and on internal control over compliance required by Circular A-133, see paragraph 13.34c.
-

13.17 Circular A-133 states that the schedule of findings and questioned costs should include all findings, including those required to be reported under *Government Auditing Standards*. Accordingly, the report on internal control over financial reporting and on compliance and other matters should refer to the schedule of findings and questioned costs, which should describe the findings required to be reported under *Government Auditing Standards* as discussed in the previous paragraph. In addition, the separate paragraph at the end of the report stating that the report is intended solely for the information and use of certain parties also should refer to federal awarding agencies and, if applicable, pass-through entities.

Reporting on Compliance and Internal Control Over Compliance Applicable to Each Major Program

13.18 This section discusses the auditor's report and opinions that are issued based on a Circular A-133 compliance audit of major programs. The report on compliance with requirements applicable to major programs expresses the auditor's opinion on whether the auditee complied with the requirements that, if noncompliance occurred, could have a direct and material effect on a major program. Statement on Auditing Standards (SAS) No. 117, *Compliance Audits* (AICPA, *Professional Standards*, vol. 1, AU sec. 801), provides requirements and guidance when reporting on compliance and internal control over compliance. Also, certain sections of AU section 508 should be adapted and applied to a Circular A-133 compliance audit. (See the appendix of SAS No. 117 for a summary of nonapplicable SAS sections.) When modification of the auditor's opinion on compliance is needed (for example, when the auditor's opinion is modified due to noncompliance or a scope restriction), the auditor should adapt and apply the requirements and guidance in AU section 508 to such report modifications.

Material Instances of Noncompliance

13.19 In accordance with AU section 508, when the audit of an auditee's compliance with requirements applicable to a major program detects material instances of noncompliance with those requirements, the auditor

should express a qualified or adverse opinion on compliance in the report on compliance with requirements that could have a direct and material effect on each major program and on internal control over compliance. The auditor should state the basis for such an opinion in the report as shown in appendix A (paragraph 13.56), examples 13-3–13-5. The auditor also should consider the cumulative effect of all instances of noncompliance on the financial statements using the materiality level established for the basic financial statements.¹⁴ Chapter 10 of this guide discusses materiality considerations in evaluating the effect of instances of noncompliance on the opinion on compliance.

Scope Limitations

13.20 Testing an auditee's compliance with laws, regulations, and the provisions of contracts or grant agreements provides the evidence for the auditor to make a comply/noncomply decision about an auditee's adherence to those compliance requirements. The auditor is able to express an unqualified opinion only if he or she has been able to apply all the procedures the auditor considers necessary in the circumstances. Restrictions on the scope of the audit—whether imposed by the client or by circumstances such as the timing of the auditor's work, an inability to obtain sufficient appropriate audit evidence, or an inadequacy in the accounting records—may require the auditor to qualify his or her opinion or to disclaim an opinion. In those instances, the auditor's report should describe the reasons for such a qualification or disclaimer of opinion. Furthermore, the auditor should consider the effects of those instances on his or her ability to express an unqualified opinion on the financial statements. Appendix A (paragraph 13.56), example 13-4, illustrates a qualified opinion on compliance due to a scope limitation.

13.21 The auditor's decision to qualify or disclaim an opinion because of a scope limitation depends on his or her assessment of the importance of the omitted procedure(s) to his or her ability to form an opinion on compliance with requirements governing each major program. This assessment will be affected by the nature and magnitude of the potential effects of the matters in question and by their significance to each major program. Restrictions imposed by the client that significantly limit the scope of the audit may require the auditor to disclaim an opinion on compliance.

13.22 When disclaiming an opinion because of a scope limitation, the auditor should indicate in a separate paragraph all of the substantive reasons for the disclaimer. The auditor should state that the scope of his or her audit was not sufficient to warrant the expression of an opinion. The auditor should not identify the procedures that were performed or include a paragraph describing the characteristics of an audit (that is, the scope paragraph); to do so may tend to overshadow the disclaimer. In addition, the auditor should disclose any reservations he or she has regarding compliance with applicable laws and regulations.

¹⁴ As discussed in the Audit and Accounting Guide *State and Local Governments*, the auditor's consideration of materiality for purposes of planning, performing, evaluating the results of, and reporting on the audit of the financial statements of a state or local government is based on opinion units.

Report on Compliance With Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance With Circular A-133

Report Requirements^{*},¹⁵

13.23 The basic elements of the auditor's standard report on compliance with requirements that could have a direct and material effect on each major program and on internal control over compliance¹⁶ in accordance with Circular A-133, as revised on June 26, 2007, are in the following listing. Appendix A (paragraph 13.56) examples 13-1–13-5 illustrate that report:

- a. A title that includes the word *independent*.
- b. A statement that the auditor has audited the auditee's compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement (Compliance Supplement)* that could have a direct and material effect on each of its major federal programs.
- c. Identification of the period covered by the report.
- d. A statement that the auditee's major federal programs are identified in the summary of the auditor's results section of the accompanying schedule of findings and questioned costs. (See paragraph 13.34a.)
- e. A statement that compliance with the requirements of laws, regulations, contracts, and grants applicable to each of the auditee's major federal programs is the responsibility of the auditee's management, and that the auditor's responsibility is to express an opinion on the auditee's compliance based on the audit.
- f. A statement that the compliance audit was conducted in accordance with auditing standards generally accepted in the United States of America (or U.S. generally accepted auditing standards),¹⁷ the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States¹⁸ and Circular A-133.
- g. A statement that those standards and Circular A-133 require that the auditor plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance

^{*} The basic elements of the auditor's report on compliance have been revised to reflect the requirements of SAS No. 117.

¹⁵ The order of the elements (paragraph 13.23) of report requirements in this paragraph is not the proper order for all reporting circumstances. Refer to specific report illustrations in paragraph 13.56 for the typical ordering of the required elements in a particular reporting circumstance.

¹⁶ In a particular single audit engagement, some controls may involve both internal control over financial reporting and internal control over compliance and thus be relevant to both the audit of the financial statements and the audit of compliance. When this occurs, those controls would be encompassed in both internal control reports. Section 505 of Circular A-133, as revised on June 26, 2007, provides guidance on reporting findings involving significant deficiencies in internal control in such a circumstance as discussed in paragraph 13.34c.

¹⁷ See the discussion beginning in paragraph 13.20 for information on report modifications due to a scope limitation.

¹⁸ The standards applicable to financial audits are the general, fieldwork, and reporting standards described in chapters 3–5 of *Government Auditing Standards*.

requirements that could have a direct and material effect on a major federal program occurred.

- h.* A statement that an audit includes examining, on a test basis, evidence about the auditee's compliance with those requirements and performing such other procedures as the auditor considered necessary in the circumstances.
- i.* A statement that the auditor believes that the compliance audit provides a reasonable basis for the auditor's opinion.
- j.* A statement that the compliance audit does not provide a legal determination of the auditee's compliance with those requirements.
- k.* An opinion on whether the auditee complied, in all material respects, with the types of compliance requirements that could have a direct and material effect on each of its major federal programs.
- l.* If instances of noncompliance are noted that result in an opinion modification, a reference to a description in the accompanying schedule of findings and questioned costs, including
 - i.* the reference number(s) of the finding(s).
 - ii.* an identification of the type(s) of compliance requirements and related major program(s).
 - iii.* a statement that compliance with such requirements is necessary, in the auditor's opinion, for the auditee to comply with the requirements applicable to the program(s).
- m.* If applicable, a statement that the results of the auditing procedures disclosed instances of noncompliance that are required to be reported in accordance with Circular A-133 and a reference to the schedule of findings and questioned costs in which they are described, including the reference number(s) of the finding(s).¹⁹
- n.* A statement that the auditee's management is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs.
- o.* A statement that in planning and performing the compliance audit, the auditor considered the auditee's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing an opinion on compliance and to test and report on internal control over compliance in accordance with Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance.
- p.* A statement that the auditor is not expressing an opinion on the effectiveness of internal control over compliance.
- q.* A statement that the auditor's consideration of internal control over compliance was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. If material weaknesses in internal control over compliance have been identified, this statement

¹⁹ Paragraph 13.37 discusses the audit findings that are required to be reported under Circular A-133.

is revised to indicate that the auditor's consideration of internal control over compliance was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses, and, therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses in internal control over compliance have been identified.

- r. The definitions of *deficiency in internal control over compliance* and *material weakness in internal control over compliance*. If applicable, a statement that deficiencies in internal control over compliance were identified that are considered to be material weaknesses and a description of the material weaknesses in internal control over compliance or a reference to the accompanying schedule of findings and questioned costs, including the reference number(s) of the finding(s).
- s. If significant deficiencies in internal control over compliance were identified, the definition of *significant deficiency in internal control over compliance*, a statement that deficiencies in internal control over compliance were identified that are considered to be significant deficiencies, and a description of the significant deficiencies in internal control over compliance or a reference to the accompanying schedule of findings and questioned costs, including the reference number(s) of the finding(s).
- t. If no material weaknesses in internal control over compliance were identified, a statement to that effect.
- u. If applicable, a statement that the auditee's response to the findings identified in the audit are described in the accompanying schedule of findings and questioned costs, and that the auditor did not audit the auditee's response and, accordingly, expresses no opinion on it.
- v. A separate paragraph at the end of the report stating that the report is intended solely for the information and use of [*identify the body or individuals charged with governance*], others within the entity, [*identify the legislative or regulatory body*], federal awarding agencies and (if applicable) pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.²⁰
- w. The manual or printed signature of the auditor's firm.
- x. The date of the auditor's report.

Further, as discussed in paragraph 13.38, the auditor may need to modify the report on compliance with requirements that could have a direct and material effect on each major program and on internal control over compliance in accordance with Circular A-133 for abuse findings reported in the federal awards section of the schedule of findings and questioned costs.

Option to Report on the Schedule of Expenditures of Federal Awards

13.24 As discussed in paragraph 13.11, this guide recommends reporting on the schedule of expenditures of federal awards in the report on the financial statements. However, in certain circumstances (for example, when a separate

²⁰ This paragraph conforms to AU section 532, *Restricting the Use of an Auditor's Report* (AICPA, *Professional Standards*, vol. 1). See AU section 532 for additional guidance on restricted-use reports.

single-audit package is issued), the auditor's report on the schedule may be incorporated into the report described in paragraph 13.23. A footnote in the illustrative report in appendix A (paragraph 13.56), example 13-1, illustrates how to incorporate the reporting on the schedule into the Circular A-133 report.

Communicating Other Findings to Management

13.25 The schedule of findings and questioned costs should include all audit findings required to be reported under Circular A-133. A separate communication (such as a management letter) may not be used to communicate such matters to the auditee in lieu of reporting them as audit findings in accordance with Circular A-133. As discussed in chapter 4 of this guide, paragraph 5.16 of *Government Auditing Standards* states that auditors should communicate in writing violations of provisions of contracts or grant agreements or abuse that have an effect on the financial statements that is less than material but more than inconsequential. This communication may be done in a management letter. Generally, *Government Auditing Standards* requires the auditor to evaluate findings for the purpose of communication in the management letter or other written communication based on their consequence to the financial statements or other financial data significant to the audit objectives. As shown in exhibit 3-1 in chapter 3 of this guide and in exhibit 13-1, in an audit in accordance with Circular A-133, however, the auditor should evaluate findings involving federal awards for the purpose of that communication based only on their consequence to the financial statements. Further, the auditor is not required to communicate such findings in a management letter or other written communication to entity officials if they are otherwise reported as audit findings in accordance with Circular A-133. The Circular A-133 report need not refer to the management letter or other written communication; as discussed in chapter 4 of this guide, that reference is made in the *Government Auditing Standards* report. In addition, as discussed in chapter 4 of this guide, *Government Auditing Standards* directs auditors to use professional judgment to determine whether and how to communicate to officials of the audited entity fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse that are inconsequential and to document any such communications.

Other Reporting Considerations

Reissuance of the Circular A-133 Report

13.26 If an auditor reissues the Circular A-133 report, the reissued report should include an explanatory paragraph stating that the report is replacing a previously issued report. Describing the reasons why the report is being reissued, and listing any changes from the previously issued report. Examples of situations in which the auditor may reissue the compliance report are (a) a quality control review performed by a governmental agency indicates that the auditor did not test a direct and material compliance requirement and (b) the discovery subsequent to the date of the compliance report that the entity had another major program that was required to be tested.

13.27 If additional procedures are performed to obtain sufficient appropriate audit evidence for all of the major programs being reported on, the auditor's report date should be updated to reflect the date the auditor obtained sufficient appropriate audit evidence regarding the events that caused the auditor to

perform new procedures. If, however, additional procedures are performed to obtain sufficient appropriate audit evidence for only some of the major programs being reported on, the auditor should dual date the report with the updated report date reflecting the date the auditor obtained sufficient appropriate audit evidence regarding the major programs affected by the circumstances and referencing the major programs for which additional audit procedures have been performed. Reissuance of an auditor-prepared document required by Circular A-133 that is incorporated by reference into the auditor's report (for example, the Schedule of Findings and Questioned Costs) is considered to be a reissuance of the report.

Dating of Reports

13.28 Because the report on the schedule of expenditures of federal awards that is presented as SI indicates that the auditor is reporting "in relation to" the basic financial statements, it should carry the same date as that on the report on the financial statements. Furthermore, because the report on internal control over financial reporting and on compliance and other matters, as required by *Government Auditing Standards*, relates to the audit of the financial statements and is based on the GAAS audit procedures performed, it also should carry the same date.

13.29 The auditor's report on compliance and on internal control over compliance related to major programs, as required by Circular A-133, ordinarily carries the same date as that of the other reports, but may carry a later date, because some of the audit work to satisfy Circular A-133 requirements may be done subsequent to the work on the financial statements. When this is the case, the reporting required by Circular A-133 should be dated at the later date (that is, when the auditor has obtained sufficient appropriate audit evidence to support the report on the audit of compliance is completed). The auditor should perform subsequent events procedures from the date of the report on the financial statements to the date of the report on the Circular A-133 compliance audit in accordance with AU section 560, *Subsequent Events* (AICPA, *Professional Standards*, vol. 1). AU section 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* (AICPA, *Professional Standards*, vol. 1), provides requirements and guidance in situations where, after the date of the reports on the financial statements and on internal control over financial reporting and on compliance and other matters, the auditor becomes aware of misstatements, instances of noncompliance, or abuse that have a direct and material effect on financial statement amounts or other financial data significant to the audit objectives.

13.30 This guide recommends reporting on the schedule of expenditures of federal awards in the report on the financial statements. However, as noted in paragraphs 13.14 and 13.24, there may be circumstances in which the auditor reports on the schedule in the report on compliance and on internal control over compliance issued to meet Circular A-133 requirements. In that situation, the report issued to meet Circular A-133 requirements should be dated the same as the report on the financial statements. That is because the report on the schedule is "in relation to" the basic financial statements. If using the same date is not possible because the work to satisfy Circular A-133 requirements is not complete as of the date of the financial statement report, the auditor has two options:

- a. The auditor can dual date the report issued to meet Circular A-133 requirements. The date related to the portion of the report pertaining to the schedule of expenditures of federal awards would be the same as the date of the financial statement report. The date pertaining to the remainder of the report would be the date when the work done to satisfy Circular A-133 requirements is completed. Refer to AU section 530, *Dating of the Independent Auditor's Report* (AICPA, *Professional Standards*, vol. 1).
- b. The auditor can issue a separate report on the schedule of expenditures of federal awards, dated the same date as that of the financial statement report.

In some instances, the auditor may be engaged to issue a stand-alone opinion on the schedule either as part of the report issued to meet the requirements of Circular A-133 or separately (dated the same as the Circular A-133 report). AU section 508 provides requirements and guidance when issuing such a report.

Other Auditors

13.31 When more than one independent auditor is involved in a single audit performed under Circular A-133, paragraphs .12–.13 of AU section 508 regarding an opinion on financial statements based in part on the report of another auditor, as well as AU section 543, *Part of Audit Performed by Other Independent Auditors* (AICPA, *Professional Standards*, vol. 1), (see chapter 4 for additional reporting considerations relating to other auditors) provides requirements and guidance. The principal auditor also may need to refer to the programs audited by other auditors in the auditor's reports on the schedule of expenditures of federal awards and on compliance with requirements that could have a direct and material effect on each major program and on the internal control over compliance as they relate to federal awards administered by the component organization. In such cases, AU section 543 provides requirements and guidance. The AICPA Audit and Accounting Guide *State and Local Governments* also illustrates an auditor's report on the financial statements that refers to the work of another auditor in the paragraph reporting on SI, such as the schedule of expenditures of federal awards.

When the Audit of Federal Awards Does Not Encompass the Entirety of the Auditee's Operations

13.32 If the audit of federal awards does not encompass the entirety of the auditee's operations expending federal awards, the operations that are not included should be identified in a separate paragraph following the first paragraph of the report on major programs. (See also the discussion in chapter 6, "Planning Considerations of Circular A-133," of this guide concerning the definition of the entity to be audited.) An example of such a paragraph follows:

Example Entity's basic financial statements include the operations of the [identify component organization, such as a component unit or department], which received [include dollar amount] in federal awards which is not included in the schedule during the year ended June 30, 20X1. Our audit, described below, did not include the operations of [identify component organization] because [state the reason for the omission, such as the component unit engaged other auditors to perform an audit in accordance with OMB Circular A-133].

Schedule of Findings and Questioned Costs

13.33 Circular A-133 states that the auditor should prepare a schedule of findings and questioned costs, which should include the following three sections:

- a. A summary of the auditor's results
- b. Findings related to the financial statements that are required to be reported in accordance with *Government Auditing Standards*
- c. Findings and questioned costs for federal awards

Appendix A (paragraph 13.56) presents an illustrative schedule of findings and questioned costs in example 13-6.

What Should Be Reported

13.34 Specifically, Circular A-133, as revised on June 26, 2007, requires the schedule of findings and questioned costs to contain the following:

- a. A summary of the auditor's results, which should include the following:
 - i. The type of report the auditor issued on the financial statements of the auditee (that is, unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion)²¹
 - ii. Where applicable, a statement that significant deficiencies in internal control were disclosed by the audit of the financial statements and whether any such deficiencies were material weaknesses²²
 - iii. A statement on whether the audit disclosed any noncompliance that is material to the financial statements of the auditee
 - iv. Where applicable, a statement that significant deficiencies in the internal control over major programs were disclosed by the audit and whether any such deficiencies were material weaknesses²³
 - v. The type of report the auditor issued on compliance for major programs (that is, unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion)

²¹ As explained in the AICPA Audit and Accounting Guide *State and Local Governments*, the auditor generally expresses or disclaims an opinion on a government's basic financial statements by providing an opinion or disclaimer of opinion on each opinion unit required to be presented in those financial statements. (See footnote 1.) Therefore, the schedule of findings and questioned costs may need to indicate multiple types of opinions on a government's basic financial statements.

²² SAS No. 115, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1, AU section 325), precludes an auditor from issuing a written report representing that no significant deficiencies were noted during an audit. Therefore, the illustrative schedule of findings and questioned costs in example 13-6 in appendix A (paragraph 13.56) uses the term *none reported* to indicate that no significant deficiencies were included in the auditor's report (versus *none*, which would imply that there were no significant deficiencies). In addition, the introductory material to Circular A-133, as revised on June 26, 2007, posted to the OMB website in March 2010 indicates that the terms *significant deficiency* and *material weakness* are to be used as defined in GAAS. SAS No. 115 revised the definition of *significant deficiency* and *material weakness*; therefore, the reporting guidelines in the circular may need to be adjusted for the revised definitions.

²³ See footnote 22.

- vi. A statement on whether the audit disclosed any audit findings that the auditor is required to report under Section 510(a) of Circular A-133 (see paragraph 13.37)²⁴
 - vii. An identification of major programs
 - viii. The dollar threshold used to distinguish between type A and type B programs as described in Section 520(b) of Circular A-133 (see chapter 8 of this guide)
 - ix. A statement on whether the auditee qualified as a low-risk auditee under Section 530 of Circular A-133 (see chapter 8 of this guide)
- b. Findings related to the financial statements that are required to be reported in accordance with *Government Auditing Standards* (see paragraph 13.35).
- c. Findings and questioned costs for federal awards, which should include audit findings as defined in Section 510(a) of Circular A-133 (see paragraph 13.36) and should include certain findings of abuse as required by *Government Auditing Standards* (see paragraph 13.38). Circular A-133 states that this section of the schedule should include the following:
- i. Audit findings (for example, internal control findings, compliance findings, questioned costs, or fraud) that relate to the same issue should be presented as one finding. Where practical, audit findings should be organized by federal agency or pass-through entity.
 - ii. Audit findings that relate to both the financial statements and the federal awards should be reported in both sections of the schedule. However, the reporting in one section of the schedule may be in summary form, with a reference to a detailed reporting in the other section of the schedule. For example, a material weakness in internal control that affects the auditee as a whole, including its federal awards, would usually be reported in detail in the section of the schedule of findings and questioned costs that is related to the financial statements, with a summary identification and reference given in the section related to federal awards. Conversely, a finding of noncompliance with a federal program law that also is material to the financial statements would be reported in detail in the federal awards section of the schedule, with a summary identification and reference given in the financial statement section.

Findings Related to the Financial Statements²⁵

13.35 As noted before, Circular A-133 requires the schedule of findings and questioned costs to include a section that presents the detail of findings

²⁴ As discussed in paragraph 13.38, the auditor may need to modify the summary of auditor's results for abuse findings reported in the federal awards section of the schedule of findings and questioned costs.

²⁵ There is no option for the auditor to report in a management letter, or other written communication, findings that *Government Auditing Standards* or Circular A-133 requires to be reported in the auditor's report or Schedule of Findings and Questioned Cost.

related to the financial statements. This section of the schedule includes all findings related to the audit of the financial statements that are required to be reported by GAAS and *Government Auditing Standards* in a Circular A-133 audit. (See paragraph 13.16.) Those findings are as follows:

- Significant deficiencies in internal control over financial reporting
- All instances of fraud and illegal acts unless inconsequential, except for fraud and illegal acts involving federal awards that are subject to Circular A-133 reporting and that are not material to financial statement amounts
- Material violations of provisions of contracts and grant agreements
- Material abuse (see also paragraph 13.38)

13.36 Chapter 4 of this guide discusses the details that *Government Auditing Standards* requires be reported for findings. That chapter also discusses the requirement in paragraph 5.26 of *Government Auditing Standards* that the auditor obtain and report the views of responsible officials concerning the findings, conclusions, and recommendations, as well as his or her planned corrective actions. The auditor should present management views and planned corrective actions for findings related to the financial statement audit in the financial statement section of the schedule of findings and questioned costs. Alternatively, for audit findings that relate to both the financial statements and the federal awards and that are reported in both sections of the schedule of findings and questioned costs, depending on the status of the development of the corrective action plan at the time the auditor's reports are released, the auditor may be able to refer to the corrective action plan as the required presentation of the auditee's views and planned corrective actions.

Findings Related to Federal Awards²⁶

13.37 Section 510(a) of Circular A-133, as amended, states that the auditor should report as audit findings in the federal awards section of the schedule of findings and questioned costs

- a. significant deficiencies in the internal control over major programs. The auditor's determination of whether a deficiency in internal control is a significant deficiency for the purpose of reporting an audit finding is in relation to a type of compliance requirement for a major program or to an audit objective identified in the *Compliance Supplement*. The auditor should identify significant deficiencies that are individually or cumulatively material weaknesses. (Chapter 9 of this guide discusses significant deficiencies and material weaknesses related to federal programs.)
- b. material noncompliance with the provisions of laws, regulations, contracts, or grant agreements related to a major program. The auditor's determination of whether noncompliance with the provisions of laws, regulations, contracts, or grant agreements is material for the purpose of reporting an audit finding is in relation to a type of compliance requirement for a major program or an audit objective identified in the *Compliance Supplement*. (Chapter 10 of this guide further discusses the evaluation and reporting of noncompliance.)

²⁶ See footnote 25 in the heading before paragraph 13.35.

- c. known questioned costs that are greater than \$10,000 for a type of compliance requirement for a major program. Known questioned costs are those specifically identified by the auditor. In evaluating the effect of questioned costs on the opinion on compliance, the auditor should consider the best estimate of the total costs questioned (likely questioned costs), not just the questioned costs specifically identified (known questioned costs). The auditor also should report (in the schedule of findings and questioned costs) known questioned costs when likely questioned costs are greater than \$10,000 for a type of compliance requirement for a major program. For example, if the auditor specifically identifies \$7,000 in questioned costs but, based on his or her evaluation of the effect of questioned costs on the opinion on compliance, estimates that the total questioned costs are in the \$50,000 to \$60,000 range, the auditor would report a finding that identifies the known questioned costs of \$7,000. Although the auditor is not required to report his or her estimate of the total questioned costs, the auditor would include information to provide proper perspective for judging the prevalence and consequences of the questioned costs.
- d. known questioned costs that are greater than \$10,000 for programs that are not audited as major. Because (except for audit follow-up) the auditor is not required to perform audit procedures for federal programs that are not major, the auditor normally will not find questioned costs. However, if the auditor does become aware of questioned costs for a federal program that is not audited as a major program (for example, as part of audit follow-up or other audit procedures) and the known questioned costs are greater than \$10,000, then the auditor should report this as an audit finding.
- e. the circumstances concerning why the auditor's report on compliance for major programs is other than an unqualified opinion, unless such circumstances are otherwise reported as audit findings in the schedule of findings and questioned costs for federal awards (for example, a scope limitation that is not otherwise reported as a finding).
- f. known fraud affecting a federal award, unless such fraud is otherwise reported as an audit finding in the schedule of findings and questioned costs for federal awards. Circular A-133 does not require the auditor to make an additional reporting when the auditor confirms that the fraud was reported outside of the auditor's reports under the direct reporting requirements of *Government Auditing Standards*. (Chapter 4 of this guide discusses the direct reporting requirements of *Government Auditing Standards*.)
- g. instances in which the results of audit follow-up procedures disclosed that the summary schedule of prior audit findings prepared by the auditee in accordance with Section 315(b) of Circular A-133 materially misrepresents the status of any prior audit finding. (See paragraphs 13.43–.45.)

Findings of Abuse

13.38 Paragraph 5.15 of *Government Auditing Standards* states that auditors should report, as applicable to the objectives of the audit, abuse that is either quantitatively or qualitatively material. That standard, like all of

the general, fieldwork, and reporting standards in *Government Auditing Standards*, applies to the entirety of the single audit, including the Circular A-133 compliance audit. As discussed in Chapter 10 of this guide, situations or transactions involving federal awards that might otherwise appear to constitute abuse instead generally are instances of noncompliance. However, there may be isolated situations or transactions involving federal awards that the auditor becomes aware of that do constitute abuse. For abuse involving federal awards that is material to the financial statement amounts,²⁷ the auditor typically would present the finding in the financial statement section of the schedule of findings and questioned costs and refer to it from the *Government Auditing Standards* report. For abuse involving federal awards that is material to a major program, the auditor typically would present the finding in the federal awards section of the schedule of findings and questioned costs and refer to it from the Circular A-133 report. (Chapter 4 of this guide provides guidance for the placement of the reference from the *Government Auditing Standards* report to abuse findings based on the primary nature of the finding. That guidance also applies in referring to findings of abuse involving federal awards in the Circular A-133 report.) As discussed in paragraph 13.34c, the auditor should report abuse findings that relate to both the financial statements and the federal awards in both sections of the schedule. Those findings may be presented in detail in one section and in summary form in the other section, with a cross-reference to the detailed presentation. If abuse findings are reported in the federal awards section of the schedule of findings and questioned costs that do not otherwise meet the Circular A-133 requirements for reporting as findings as discussed in paragraph 13.37, modification of both (a) the report on compliance with requirements that could have a direct and material effect on each major program and on internal control over compliance and (b) the summary of the auditor's results section of the schedule of findings and questioned costs may be appropriate.

Detail of Audit Findings—Federal Awards

13.39 Section 510(b) of Circular A-133 states that audit findings should be presented in sufficient detail for the auditee to prepare a corrective action plan and take corrective action and for federal agencies and pass-through entities to arrive at a management decision. (However, as certain laws and regulations may require audit reports to be made publicly available, the auditor is cautioned not to include names, Social Security numbers, other personal identification, or other potentially sensitive information in the body of the audit reports or any attached or referenced schedules or letters.) The following specific information should be included according to Circular A-133 (as applicable):

- a. Identification of the federal program and specific federal award, including:
 - i. The *Catalog of Federal Domestic Assistance* (CFDA) title and number.
 - ii. The federal award number and year.
 - iii. The name of the federal agency.
 - iv. The name of the applicable pass-through entity.

When information such as the CFDA title and number or the federal award number is not available, the auditor should provide the best

²⁷ See footnote 14.

information available to describe the federal award. (Chapter 7 of this guide discusses an alternative for presentation if a CFDA number is not available.)

- b. The criteria or specific requirement upon which the audit finding is based, including the statutory, regulatory, or other citation.
- c. The condition found, including facts that support the deficiency identified in the audit finding.
- d. Identification of questioned costs and how they were computed.
- e. Information to provide a proper perspective for judging the prevalence and consequences of the audit findings (for example, whether the audit findings represent an isolated instance or a systemic problem). Where appropriate, the instances identified should be related to the universe and the number of cases examined and be quantified in terms of the dollar value.
- f. The possible asserted effect to provide sufficient information to the auditee and federal agency (or pass-through entity, in the case of a subrecipient) to permit them to determine the cause and effect, to facilitate prompt and proper corrective action.
- g. Recommendations to prevent future occurrences of the deficiency identified in the audit finding.

13.40 Audit findings related to federal awards also should meet the presentation requirements of *Government Auditing Standards*. Chapter 4 of this guide discusses the details that *Government Auditing Standards* requires be reported for findings. That chapter also discusses the requirements in paragraph 4.17 of *Government Auditing Standards* that the elements of a finding include the cause, as well as paragraphs 5.32–38 of *Government Auditing Standards* that the auditor obtain and report the views of responsible officials concerning the findings, conclusions, and recommendations, including planned corrective actions.²⁸ Therefore, even though not specifically discussed in Circular A-133, the auditor should include as an element of each finding the cause of the finding. Further, the auditor should report management views and planned corrective actions for findings related to federal awards in the federal awards section of the schedule of findings and questioned costs. Alternatively, depending on the status of the development of the corrective action plan at the time the auditor's reports are released, the auditor may be able to refer to the corrective action plan as the required presentation of the auditee's views and planned corrective actions.

Other Preparation Guidance

13.41 Each audit finding in the schedule of findings and questioned costs should include a reference number to allow for easy referencing of the audit findings during follow-up. One option for assigning reference numbers is to use the fiscal year being audited as the beginning digits of each reference number, followed by a numeric sequence. For example, findings identified and reported

²⁸ Paragraph 5.37 of *Government Auditing Standards* states that if the auditee's comments are inconsistent or in conflict with the report's findings, conclusions, or recommendations, and are not, in the auditors' opinion, valid—or when the planned corrective actions do not adequately address the auditors' recommendations—the auditor should state reasons for disagreeing with the comments or planned corrective actions. That requirement subsumes the requirement in Section 510(b)(8) of Circular A-133 that audit findings include the views of responsible officials when there is disagreement with the audit findings, to the extent practical.

in the audit of fiscal year 20X1 would be assigned reference numbers 20X1-1, 20X1-2, and so forth.

13.42 The auditor is required to issue a schedule of findings and questioned costs for every Circular A-133 audit, regardless of whether any findings or questioned costs are noted. That is because Circular A-133 requires that one section of the schedule summarize the audit results. (See paragraphs 13.33–.34.) In a situation in which there are no findings or questioned costs, the auditor should prepare the summary of auditor's results section of the schedule and either omit the other sections or include them, indicating that no matters were reported.

Summary Schedule of Prior Audit Findings and Corrective Action Plan

13.43 The auditee is responsible for follow-up and corrective action on all audit findings. As part of this responsibility, the auditee should prepare a summary schedule of prior audit findings. The auditee is not required to prepare a summary schedule of prior audit findings if there are no matters reportable therein. The auditee also should prepare a corrective action plan that addresses each of the current-year audit findings.²⁹ The summary schedule of prior audit findings and the corrective action plan, both of which are part of the reporting package, should include the reference numbers the auditor assigns to audit findings in the schedule of findings and questioned costs. This numbering (or other identification) should include the fiscal year in which the finding initially occurred.

13.44 The auditor should follow up on prior audit findings, perform procedures to assess the reasonableness of the summary schedule of prior audit findings prepared by the auditee, and report, as a current-year audit finding, when the auditor concludes that the summary schedule of prior audit findings materially misrepresents the status of any prior audit finding in accordance with the requirements of Section 500(e) of Circular A-133. (Chapter 10 of this guide discusses follow-up procedures.)

13.45 The auditor has no responsibility for the corrective action plan; however, the auditor may be separately engaged by the auditee for assistance in developing appropriate corrective actions in response to audit findings. The auditor may find the auditee's corrective action plan useful in performing follow-up on prior audit findings (in addition to the schedule of prior audit findings) because it may provide an indication of the corrective steps planned by the auditee.

Data Collection Form

13.46 Circular A-133 states that the auditee should submit a DCF that states whether the audit was completed in accordance with Circular A-133 and provides information about the auditee, its federal programs, and the results

²⁹ Paragraph 5.32 of *Government Auditing Standards* states that the auditor should obtain and report the views of responsible auditee officials concerning the findings, conclusions, and recommendations, as well as planned corrective actions. Paragraphs 13.36 and 13.40 discuss the interaction of that *Government Auditing Standards* requirement and the Circular A-133 requirement that the auditee prepare a corrective action plan.

of the audit. This form is not part of the reporting package. The information required to be included in the form, however, represents a summary of the information contained in the reporting package, including the auditor's reports and the auditee's schedule of expenditures of federal awards. The auditee completes the DCF online (through the FAC website at <http://harvester.census.gov/sac>) and electronically certifies it (via an online signature) upon submission.

13.47 In addition, the auditor is required to complete certain sections of the DCF online (for example, auditor contact information, and information on the results of the financial statement audit and the Circular A-133 compliance audit of federal programs) and electronically certify (via an online signature) an auditor statement provided on the form. The auditor statement indicates, at a minimum, the source of the information included in the form, the auditor's responsibility for the information, that the form is not a substitute for the reporting package, and that the content of the form is limited to the data elements prescribed by the OMB. As part of completing the DCF, the auditor is asked to date it. The date that is entered by the auditor should be the date when he or she completes electronically signs the DCF. The wording of the auditor's statement section of the DCF indicates that no additional procedures were performed since the date of the audit reports. This wording releases the auditor from any subsequent-event responsibility with regard to the timing of the completion of the form and the completion of the audit.

13.48 The DCF and related instructions can be accessed from the FAC's website at <http://harvester.census.gov/sac>. The form number is SF-SAC.³⁰ The FAC requires electronic submission of the DCF via an online Internet Data Entry System.

Submission of Reporting Package and Data Collection Form

13.49 The auditee is responsible for electronically submitting the DCF (Form SF-SAC) and the reporting package, including the auditor's reports. After the DCF is completed and the reporting package is uploaded to the FAC website (<http://harvester.census.gov/sac>) by the auditee, the certification process (described in paragraphs 13.46–.48) by both the auditee and the auditor completes the submission. The auditee should submit Form SF-SAC and the reporting package within the earlier of 30 days after the receipt of the auditor's reports or 9 months after the end of the audit period, unless a longer period is agreed to in advance by the cognizant or oversight agency for audit.[†]

³⁰ The OMB periodically revises the data collection form (DCF) and its accompanying instructions. Recently, the OMB issued an updated DCF for 2010–2012 audits. Auditors are cautioned to make sure they complete the version of the form and instructions that applies to the fiscal year audited.

[†] In March 2010, the OMB advised federal agencies in a memorandum titled "Updated Guidance on the American Recovery and Reinvestment Act (M-10-14)" that they should not grant any extension requests to grantees for fiscal years 2009–2011. Appendix 7 of the 2010 *OMB Circular A-133 Compliance Supplement (Compliance Supplement)* is expected to emphasize this point and note that federal agencies have either already adopted this policy or are in the process of adopting it. (At the time of this writing, the *Compliance Supplement* is expected to include this information related to extension requests. It is important that readers be alert to final issuance of the *Compliance Supplement*, which will be available on the OMB website at www.whitehouse.gov/omb/grants_circulars/.)

Submission by Subrecipients

13.50 In addition to the submission requirements discussed in paragraph 13.49, auditees that also are subrecipients should submit to each pass-through entity one copy of the reporting package when the schedule of findings and questioned costs disclosed audit findings related to federal awards that the pass-through entity provided or when the summary schedule of prior audit findings reported the status of any audit findings related to federal awards that the pass-through entity provided. When a subrecipient is not required to submit a reporting package to a pass-through entity, the subrecipient instead should provide written notification to the pass-through entity that

- an audit of the subrecipient was conducted in accordance with Circular A-133 (including the period covered by the audit and the name, amount, and CFDA number of the federal awards provided by the pass-through entity).
- the schedule of findings and questioned costs disclosed no audit findings related to the federal awards that the pass-through entity provided.
- the summary schedule of prior audit findings did not report on the status of any audit findings related to the federal awards that the pass-through entity provided.

A subrecipient may submit a copy of the reporting package to a pass-through entity to comply with this notification requirement.

Distribution of Reporting Package to Federal Agencies

13.51 Once the reporting package is uploaded to the FAC, the FAC will distribute the reporting package to the appropriate federal agencies identified in the DCF.

13.52 If the auditee or auditor revises a previous submission or other communication made to the FAC, such changes are done on the FAC website. See the FAC website for the most current information on the process for situations in which there are revisions to the form or other communication, including instructions for submitting those revisions to the FAC.

Freedom of Information Act and Similar Laws and Regulations

13.53 Often, federal, state, and local laws and regulations, such as the Freedom of Information Act (*Government Organization and Employees*, U.S. Code Title 5, Section 552), require governments to release certain documents, including audit reports and management letters of organizations for which the government has oversight responsibilities, to members of the press and the general public. Other laws and regulations require that audit reports of governments be made publicly available. Accordingly, the auditor is cautioned not to include names, Social Security numbers, other personal identification, or other potentially sensitive matters in the body of audit reports or any attached or referenced schedules or letters.

American Recovery and Reinvestment Act Considerations[‡]

13.54 When listing expenditures of Recovery Act awards in reports, those expenditures must be shown separately from non-Recovery Act expenditures. Appendix 7 of the *Compliance Supplement*^{||} notes that Recovery Act expenditures should be shown separately on the Schedule of Expenditures of Federal Awards, and as separate rows under item 9 of Part III on the DCF (SF-SAC) by CFDA number, and inclusion of the prefix "ARRA" in identifying the award.

13.55 The auditor should include in the audit finding detail of the Schedule of Findings and Questioned Costs explicit identification of Recovery Act programs. This requirement of separate identification of findings related to Recovery Act funds can be found in Appendix 7 of the *Compliance Supplement*.^{||}

[‡] Information in this guide related to the American Recovery and Reinvestment Act of 2009 (Recovery Act) is based upon the latest information available at the time of this writing. However, this information is subject to change because guidance from the OMB is being issued and updated on an ongoing basis. It is important for recipients of Recovery Act funding, and their auditors, to monitor the guidance issued. For the latest OMB guidance, go to the OMB website at www.whitehouse.gov/omb/recovery_default. Information can also be found at the Recovery Act Resource Center on the Governmental Audit Quality Center website, which is open to the public at www.aicpa.org/INTERESTAREAS/GOVERNMENTALAUDITQUALITY/RESOURCES/RECOVERYACTRESOURCECENTER/Pages/default.aspx and at the U.S. Government's official Recovery Act website at www.recovery.gov.

^{||} At the time of this writing, the *Compliance Supplement* is expected to include the information contained in this paragraph. It is important that readers be alert to final issuance of the *Compliance Supplement*, which will be available on the OMB website at www.whitehouse.gov/omb/grants_circulars/.

Appendix A—Illustrative Auditor's Reports Under Circular A-133

This appendix contains examples of the report on compliance with requirements that could have a direct and material effect on each major program and on internal control over compliance issued under Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133), as revised on June 26, 2007, in various circumstances for a Circular A-133 compliance audit as discussed in this chapter. These reports are based on Statement on Auditing Standards (SAS) No. 115, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 325)* and related interpretations and have been updated for SAS No. 117, *Compliance Audits* (AICPA, *Professional Standards*, vol. 1, AU sec. 801). The following table lists the illustrative reports. Auditors, using professional judgment, may adapt these examples to other situations not specifically addressed in this guide.

| <i>Example No.</i> | <i>Title</i> |
|--------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 13-1 | Report on Compliance With Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 (<i>Unqualified Opinion on Compliance; No Material Weaknesses or Significant Deficiencies in Internal Control Over Compliance Identified</i>) |
| 13-2 | Report on Compliance With Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 (<i>Unqualified Opinion on Compliance; Significant Deficiencies in Internal Control Over Compliance Identified</i>) |
| 13-3 | Report on Compliance With Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 (<i>Qualified Opinion on Compliance; Material Weaknesses and Significant Deficiencies in Internal Control Over Compliance Identified</i>) |

(continued)

* The Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133), includes guidelines for reporting *significant deficiencies* and *material weaknesses*. In March, 2010, the OMB issued a statement on its website clarifying that these terms are to be used as defined in generally accepted auditing standards issued by the AICPA and Government Auditing Standards issued by the Government Accountability Office. Also in March 2010, the AICPA issued Interpretation No. 1, "Communicating Deficiencies in Internal Control Over Compliance in an Office of Management and Budget Circular A-133 Audit," of AU section 325, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 9325 par. .01-.04), that provides updated definitions for reporting on internal control over compliance in a Circular A-133 compliance audit.

| Example No. | Title |
|-------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 13-4 | Report on Compliance With Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 (<i>Qualified Opinion on Compliance—Scope Limitation for One Major Program; Unqualified Opinion on Compliance for the Other Major Programs; Significant Deficiencies in Internal Control Over Compliance Identified</i>) |
| 13-5 | Report on Compliance With Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 (<i>Adverse Opinion on Compliance for One Major Program; Unqualified Opinion on Compliance for the Other Major Programs; Material Weaknesses and Significant Deficiencies in Internal Control Over Compliance Identified</i>) |
| 13-6 | Schedule of Findings and Questioned Costs |

In a single audit, auditors also are required to issue (a) an opinion (or disclaimer of opinion) on the financial statements and on the supplementary schedule of expenditures of federal awards and (b) a report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with *Government Auditing Standards*. Appendix A in chapter 4, "Auditor Reporting Requirements and Other Communication Considerations of *Government Auditing Standards*," of this guide and paragraphs 13.12–.13 illustrate those reports. Appendix A in chapter 14, "Program-Specific Audits," of this guide illustrates the reports issued for a program-specific audit.

Example 13-1

Report on Compliance With Requirements That Could Have a Direct and Material[†] Effect on Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 (Unqualified Opinion on Compliance; No Material Weaknesses or Significant Deficiencies in Internal Control Over Compliance Identified)¹

Independent Auditor's Report

[Addressee]

Compliance²

We have audited Example Entity's compliance with the types of compliance requirements³ described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Example Entity's major federal programs for the year ended June 30, 20X1. Example Entity's major federal programs are identified in the summary of auditor's results section

[†] Statement on Auditing Standards (SAS) No. 117, *Compliance Audits* (AICPA, *Professional Standards*, vol. 1, AU sec. 801), defines *applicable compliance requirements* as the compliance requirements that are subject to the compliance audit. According to Section 505 of Circular A-133, the auditor's report on compliance with laws, regulations, and the provisions of contracts or grant agreements should include an opinion (or disclaimer of opinion) as to whether the auditee complied with laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on each major program. Therefore, in a Circular A-133 compliance audit, the *applicable compliance requirements*, as the term is used in SAS No. 117, are those that could have a direct and material effect on a major program. Accordingly, for the purpose of adapting SAS No. 117 to a Circular A-133 compliance audit, the term *applicable* has been replaced by *direct and material* when referencing such compliance requirements in this report. See also footnote 3 of this appendix for a discussion related to the determination of material noncompliance.

¹ The portions of examples 13-1–13-5 relating to compliance and internal control over compliance may be used in drafting a report for situations that are not addressed in the illustrative reports. For example, if the auditor is expressing an unqualified opinion on compliance and has identified significant deficiencies, but no material weaknesses, the compliance section of examples 13-1 or 13-2 may be used along with the internal control section of examples 13-2 or 13-4. Alternatively, if the auditor is expressing a modified opinion on compliance and has not identified significant deficiencies, the internal control section of this report may be used along with the compliance section of examples 13-3–13-5. For situations in which the auditor has identified material weaknesses, the internal control section of example 13-3 or 13-5 may be used. See also paragraph 13.38 concerning the need to modify this report if the federal awards section of the schedule of findings and questioned costs includes abuse findings.

² This report sequences the reporting on compliance before the reporting on internal control over compliance. However, *Government Auditing Standards* reports in appendix A in chapter 4, "Auditor Reporting Requirements and Other Communication Considerations of Government Auditing Standards," of this guide sequence the reporting on internal control over financial reporting before the reporting on compliance and other matters. Auditors may present the internal control over compliance and compliance sections of Circular A-133 and *Government Auditing Standards* reports in whichever sequence better meets their needs.

³ Under Section 510(a) of Circular A-133, the auditor's determination of whether a noncompliance with the provisions of laws, regulations, contracts, or grant agreements is material for the purpose of reporting an audit finding is in relation to a type of compliance requirement for a major program or an audit objective identified in the *OMB Circular A-133 Compliance Supplement (Compliance Supplement)*. Further, the auditor's determination of whether a deficiency in internal control over compliance is a material weakness or significant deficiency for the purpose of reporting an audit finding is also in relation to a type of compliance requirement for a major program or an audit objective identified in the *Compliance Supplement*. The reference to "type of compliance requirements" used here and elsewhere in this report illustration refers to the 14 types of compliance requirements (identified as "A" through "N") described in Part 3 of the *Compliance Supplement*. For purposes of reporting audit findings, auditors are alerted that certain of the types of compliance requirements may include multiple compliance requirements with multiple audit objectives (for example, compliance requirement "G" covers three separate requirements [matching, level of effort, and earmarking], and "N" covers separate requirements specific to each individual special test and provision).

of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Example Entity's management. Our responsibility is to express an opinion on Example Entity's compliance based on our audit.⁴

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*,⁵ issued by the Comptroller General of the United States; and OMB Circular A-133. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Example Entity's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Example Entity's compliance with those requirements.

In our opinion, Example Entity complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 20X1. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items [list the reference numbers of the related findings, for example, 20X1-3 and 20X1-6].⁶

Internal Control Over Compliance

Management of Example Entity is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Example Entity's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control

⁴ As discussed in paragraph 13.32 and in chapter 6, "Planning Considerations of Circular A-133," of this guide, there are situations in which the audit of federal awards may not encompass the entirety of the auditee's operations. In this case, the operations that are not included should be identified in a separate paragraph following the first paragraph of the report. An example of such a paragraph follows:

Example Entity's basic financial statements include the operations of the [identify component organization, such as a component unit or department], which received [include dollar amount] in federal awards which is not included in the schedule during the year ended June 30, 20X1. Our audit, described below, did not include the operations of [identify component organization] because [state the reason for the omission, such as the component unit engaged other auditors to perform an audit in accordance with Circular A-133].

⁵ The standards applicable to financial audits are the general, fieldwork, and reporting standards described in chapters 3–5 of *Government Auditing Standards*.

⁶ When there are no such instances of noncompliance identified in the schedule of findings and questioned costs, the last sentence would be omitted.

over compliance. Accordingly, we do not express an opinion on the effectiveness of Example Entity's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be *material weaknesses*, as defined above.⁷

Example Entity's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not

⁷ As discussed in paragraphs 13.14 and 13.24, there may be instances in which it would be appropriate to report on the schedule of expenditures of federal awards in this report (that is, a separate single audit package is issued). In such a circumstance, a new section would be added immediately following this paragraph. For audits of not-for-profit organizations, the wording of the new section is as follows:

Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of Example Entity as of and for the year ended June 30, 20X1, and have issued our report thereon dated August 15, 20X1. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

For audits of governmental entities, the wording of this new section is as follows:

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of Example Entity as of and for the year ended June 30, 20X1, and have issued our report thereon dated August 15, 20X1. Our audit was performed for the purpose of forming our opinions on the financial statements that collectively comprise Example Entity's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

See paragraph 13.30 for guidance on dating of reports when the reporting on the schedule of expenditures of federal awards is included in this report. Additionally, when reporting on the supplementary information, the auditor should consider the effect of any modifications to the report on the basic financial statements (for example, a qualified opinion, a modification as to consistency because of a change in accounting principle, or a reference to the report of other auditors). Furthermore, if the report on supplementary information is other than unqualified, this paragraph should be modified accordingly. Guidance for reporting in these circumstances is described in paragraphs .09–.11 and .13–.14 of AU section 551, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents* (AICPA, *Professional Standards*, vol. 1).

audit Example Entity's responses and, accordingly, we express no opinion on the responses.^{8,9}

This report is intended solely for the information and use of management, [*identify the body or individuals charged with governance*], others within the entity, [*identify the legislative or regulatory body*], federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.¹⁰

[*Signature*]

[*Date*]

⁸ If, as noted in footnote 6, there are no findings referred to in this report (or identified in the schedule of findings and questioned costs), this paragraph would be omitted.

⁹ Although the auditor does not audit management's responses to identified findings, the auditor does have certain responsibilities related to reporting the views of responsible officials under *Government Auditing Standards*. As noted in paragraph 5.32 of *Government Auditing Standards*, auditors should obtain and report the views of responsible officials concerning the findings, conclusions, and recommendations, as well as planned corrective actions. See paragraph 13.36 for further information.

¹⁰ This paragraph conforms to AU section 532, *Restricting the Use of an Auditor's Report* (AICPA, *Professional Standards*, vol. 1). See AU section 532 for additional guidance on restricted-use reports.

Example 13-2

Report on Compliance With Requirements That Could Have a Direct and Material[†] Effect on Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 (Unqualified Opinion on Compliance; Significant Deficiencies in Internal Control Over Compliance Identified)¹¹

Independent Auditor's Report

[Addressee]

Compliance¹²

We have audited Example Entity's compliance with the types of compliance requirements¹³ described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Example Entity's major federal programs for the year ended June 30, 20X1. Example Entity's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Example Entity's management. Our responsibility is to express an opinion on Example Entity's compliance based on our audit.¹⁴

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*,¹⁵ issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Example Entity's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Example Entity's compliance with those requirements.

In our opinion, Example Entity complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 20X1. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items [list the reference numbers of the related findings, for example, 20X1-3 and 20X1-6].¹⁶

[†] See footnote † in example 13-1.

¹¹ See footnote 1.

¹² See footnote 2.

¹³ See footnote 3.

¹⁴ See footnote 4.

¹⁵ See footnote 5.

¹⁶ See footnote 6.

Internal Control Over Compliance

Management of Example Entity is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Example Entity's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Example Entity's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies as described in the accompanying schedule of findings and questioned costs as items [list the reference numbers of the related findings, for example, 20X1-7, 20X1-8, and 20X1-9]. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.¹⁷

Example Entity's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit Example Entity's responses and, accordingly, we express no opinion on the responses.¹⁸

This report is intended solely for the information and use of management, [*identify the body of individuals charged with governance*], others within the entity, [*identify the legislative or regulatory body*], federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.¹⁹

[Signature]

[Date]

¹⁷ See footnote 7.

¹⁸ See footnote 9.

¹⁹ See footnote 10.

Example 13-3

Report on Compliance With Requirements That Could Have a Direct and Material[†] Effect on Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 (*Qualified Opinion on Compliance; Material Weaknesses and Significant Deficiencies in Internal Control Over Compliance Identified*)²⁰

Independent Auditor's Report

[Addressee]

Compliance²¹

We have audited Example Entity's compliance with the types of compliance requirements²² described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Example Entity's major federal programs for the year ended June 30, 20X1. Example Entity's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Example Entity's management. Our responsibility is to express an opinion on Example Entity's compliance based on our audit.²³

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*,²⁴ issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Example Entity's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Example Entity's compliance with those requirements.

As described in item(s) [*list the reference numbers of the related findings, for example, 20X1-10 and 20X1-4*] in the accompanying schedule of findings and questioned costs, Example Entity did not comply with requirements regarding [*identify the type(s) of compliance requirement*] that are applicable to its [*identify the major federal program*]. Compliance with such requirements is necessary, in our opinion, for Example Entity to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, Example Entity complied, in all material respects, with the compliance

[†] See footnote † in example 13-1.

²⁰ See footnote 1.

²¹ See footnote 2.

²² See footnote 3.

²³ See footnote 4.

²⁴ See footnote 5.

requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 20X1.²⁵

Internal Control Over Compliance

Management of Example Entity is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Example Entity's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Example Entity's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.²⁶

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items [list the reference numbers of the related findings, for example 20X1-8 and 20X1-9] to be material weaknesses.

A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the deficiencies in internal control over compliance described in the accompanying schedule of

²⁵ When other instances of noncompliance are identified in the schedule of findings and questioned costs as required by Circular A-133, the following sentence may be added:

The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items [list the reference numbers of the related findings, for example, 20X1-3, and 20X1-6].

²⁶ If no significant deficiencies were identified, this sentence would read as follows:

However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses.

findings and questioned costs as items [*list the reference numbers of the related findings, for example 20X1-6 and 20X1-7*] to be significant deficiencies.^{27,28}

Example Entity's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit Example Entity's responses and, accordingly, we express no opinion on the responses.²⁹

This report is intended solely for the information and use of management, [*identify the body or individuals charged with governance*], others within the entity, [*identify the legislative or regulatory body*], federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.³⁰

[*Signature*]

[*Date*]

²⁷ See footnote 7.

²⁸ If no significant deficiencies were identified, this paragraph would be deleted.

²⁹ See footnote 9.

³⁰ See footnote 10.

Example 13-4

Report on Compliance With Requirements That Could Have a Direct and Material[†] Effect on Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 (*Qualified Opinion on Compliance—Scope Limitation for One Major Program; Unqualified Opinion on Compliance for the Other Major Programs; Significant Deficiencies in Internal Control Over Compliance Identified*)^{31,32}

Independent Auditor's Report

[Addressee]

Compliance³³

We have audited Example Entity's compliance with the types of compliance requirements³⁴ described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Example Entity's major federal programs for the year ended June 30, 20X1. Example Entity's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Example Entity's management. Our responsibility is to express an opinion on Example Entity's compliance based on our audit.³⁵

Except as discussed in the following paragraph, we conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*,³⁶ issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Example Entity's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Example Entity's compliance with those requirements.

We were unable to obtain sufficient documentation supporting the compliance of Example Entity with [identify the major federal program] regarding [identify the type(s) of compliance requirement], nor were we able to satisfy ourselves as to Example Entity's compliance with those requirements by other auditing procedures.

[†] See footnote † in example 13-1.

³¹ See footnote 1.

³² Although this report identifies a significant deficiency, circumstances may warrant a material weakness to be reported. Please refer to examples 13-3 and 13-5 for illustrations on how to report material weaknesses.

³³ See footnote 2.

³⁴ See footnote 3.

³⁵ See footnote 4.

³⁶ See footnote 5.

In our opinion, except for the effects of such noncompliance, if any, as might have been determined had we been able to examine sufficient evidence regarding Example Entity's compliance with the requirements of [*identify the major federal program*] regarding [*identify the type(s) of compliance requirement*], Example Entity complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 20X1.³⁷

Internal Control Over Compliance

Management of Example Entity is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Example Entity's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Example Entity's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies as described in the accompanying schedule of findings and questioned costs as items [list the reference numbers of the related findings, for example, 20X1-7, 20X1-8, and 20X1-9]. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.³⁸

Example Entity's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit Example Entity's responses and, accordingly, we express no opinion on the responses.³⁹

³⁷ See footnote 25.

³⁸ See footnote 7.

³⁹ See footnote 9.

This report is intended solely for the information and use of management, [*identify the body or individuals charged with governance*], others within the entity, [*identify the legislative or regulatory body*], federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.⁴⁰

[*Signature*]

[*Date*]

⁴⁰ See footnote 10.

Example 13-5

Report on Compliance With Requirements That Could Have a Direct and Material[†] Effect on Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 (*Adverse Opinion on Compliance for One Major Program; Unqualified Opinion on Compliance for the Other Major Programs; Material Weaknesses and Significant Deficiencies in Internal Control Over Compliance Identified*)⁴¹

Independent Auditor's Report

[Addressee]

Compliance⁴²

We have audited Example Entity's compliance with the types of compliance requirements⁴³ described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Example Entity's major federal programs for the year ended June 30, 20X1. Example Entity's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Example Entity's management. Our responsibility is to express an opinion on Example Entity's compliance based on our audit.⁴⁴

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*,⁴⁵ issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Example Entity's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Example Entity's compliance with those requirements.

As described in items [list the reference numbers of the related findings, for example, 20X1-10, 20X1-11, and 20X1-12] in the accompanying schedule of findings and questioned costs, Example Entity did not comply with requirements regarding [identify the types of compliance requirements] that are applicable to its [identify the major federal program]. Compliance with such requirements is necessary, in our opinion, for Example Entity to comply with requirements applicable to that program.

[†] See footnote † in example 13-1.

⁴¹ See footnote 1.

⁴² See footnote 2.

⁴³ See footnote 3.

⁴⁴ See footnote 4.

⁴⁵ See footnote 5.

In our opinion, because of the effects of the noncompliance described in the preceding paragraph, Example Entity did not comply in all material respects, with the requirements referred to above that could have a direct and material effect on [identify the major federal program]. Also, in our opinion, Example Entity complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its other major federal programs for the year ended June 30, 20X1.⁴⁶

Internal Control Over Compliance

Management of Example Entity is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Example Entity's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Example Entity's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.⁴⁷

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items [list the reference numbers of the related findings, for example 20X1-8 and 20X1-9] to be material weaknesses.

A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the deficiencies in internal control over compliance described in the accompanying schedule of

⁴⁶ See footnote 25.

⁴⁷ See footnote 26.

findings and questioned costs as items [*list the reference numbers of the related findings, for example, 20X1-7 and 20X1-10*] to be significant deficiencies.^{48,49}

Example Entity's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit Example Entity's responses and, accordingly, we express no opinion on the responses.⁵⁰

This report is intended solely for the information and use of management, [*identify the body or individuals charged with governance*], others within the entity, [*identify the legislative or regulatory body*], federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.⁵¹

[*Signature*]

[*Date*]

⁴⁸ See footnote 7.

⁴⁹ See footnote 28.

⁵⁰ See footnote 9.

⁵¹ See footnote 10.

Example 13-6

Schedule of Findings and Questioned Costs

Section I—Summary of Auditor's Results

Financial Statements

Type of auditor's report issued [*unqualified, qualified, adverse, or disclaimer*]:⁵²

Internal control over financial reporting:

- Material weakness(es) identified?

_____yes

_____no
- Significant deficiency(ies) identified?

_____yes

_____none reported

Noncompliance material to financial statements noted? _____yes _____no

Federal Awards

Internal control over major programs:

- Material weakness(es) identified?

_____yes

_____no
- Significant deficiency(ies) identified?

_____yes

_____none reported

Type of auditor's report issued on compliance for major programs [*unqualified, qualified, adverse, or disclaimer*]:⁵³

Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133? _____yes _____no

Identification of major programs:⁵⁴

⁵² As explained in the AICPA Audit and Accounting Guide *State and Local Governments*, the auditor generally expresses or disclaims an opinion on a government's basic financial statements by providing an opinion or disclaimer of opinion on each opinion unit required to be presented in those financial statements. Therefore, there could be multiple responses to this question for audits of a government's basic financial statements.

⁵³ If the audit report for one or more major programs is other than unqualified, indicate the type of report issued for each program. For example, if the audit report on major program compliance for an auditee having five major programs includes an unqualified opinion for three of the programs, a qualified opinion for one program, and a disclaimer of opinion for one program, the response to this question could be as follows: "Unqualified for all major programs except for [*name of program*], which was qualified and [*name of program*], which was a disclaimer."

⁵⁴ Major programs generally would be identified in the same order as reported on the schedule of expenditures of federal awards.

CFDA Number(s)⁵⁵Name of Federal
Program or Cluster⁵⁶Dollar threshold used to distinguish between
type A and type B programs:

\$_____

Auditee qualified as low-risk auditee?

____ yes ____ no

Section II—Financial Statement Findings

This section should identify the significant deficiencies, material weaknesses, fraud, illegal acts, violations of provisions of contracts and grant agreements, and abuse related to the financial statements for which Government Auditing Standards requires reporting in a Circular A-133 audit. (See paragraphs 13.15 and 13.35.) Auditors may refer to chapter 4 of this guide for a discussion of the Government Auditing Standards requirements for presenting findings.

Audit findings that relate to both the financial statements and federal awards should be reported in both section II and section III. However, the reporting in one section may be in summary form with a reference to a detailed reporting in the other section of the schedule. For example, a material weakness in internal control that affects an entity as a whole, including its federal awards, generally would be reported in detail in this section. Section III would then include a summary identification of the finding and a reference back to the specific finding in this section.

Identify each finding with a reference number.⁵⁷ If there are no findings, this section could state that no matters were reported. Alternatively, this section could be omitted without confusing the schedule's users because the summary of auditor's results section would indicate that there are no findings. Each finding should be presented in the level of detail shown in the following listing, as applicable. Auditors also may refer to chapter 4 of this guide for a discussion of the Government Auditing Standards requirements for presenting findings.

- *Criteria or specific requirement*
- *Condition*
- *Context⁵⁸*
- *Effect*

⁵⁵ When the *Catalog of Federal Domestic Assistance* (CFDA) number is not available, include other identifying number, if applicable.

⁵⁶ The name of the federal program or cluster should be the same as that listed in the schedule of expenditures of federal awards. For clusters, auditors are required only to list the name of the cluster and not each individual award or program within the cluster.

⁵⁷ One option for assigning reference numbers is to use the fiscal year being audited as the beginning digits of each reference number, followed by a numeric sequence. For example, findings identified and reported in the audit of fiscal year 20X1 would be assigned reference numbers of 20X1-1, 20X1-2, and so forth.

⁵⁸ Describe the work performed that resulted in the finding, and provide sufficient information for judging the prevalence and consequences of the finding, such as the relation to the population or universe of costs or the number of cases examined as well as quantification of audit findings in dollars.

- Cause
- Recommendation
- Views of responsible officials and planned corrective actions⁵⁹

Section III—Federal Award Findings and Questioned Costs

This section should identify the audit findings required to be reported by Section 510(a) of Circular A-133 (for example, significant deficiencies, material weaknesses, and material instances of noncompliance, including questioned costs—see paragraph 13.37) as well as any abuse findings involving federal awards that is material to a major program (see paragraph 13.38). Where practical, findings should be organized by federal agency or pass-through entity.

Audit findings that relate to both the financial statements and federal awards should be reported in both section II and section III. However, the reporting in one section may be in summary form with a reference to a detailed reporting in the other section of the schedule. For example, a finding of noncompliance with a federal program law that is also material to the financial statements generally would be reported in detail in this section. Section II would then include a summary identification of the finding and a reference back to the specific finding in this section.

Identify each finding with a reference number.⁶⁰ If there are no findings, this section could state that no matters were reported. Alternatively, this section could be omitted without confusing the schedule's users because the summary of auditor's results section would indicate that there are no findings. Each finding should be presented in the level of detail shown in the following listing, as applicable. Auditors also may refer to chapter 4 of this guide for a discussion of the Government Auditing Standards requirements for presenting findings.

- Information on the federal program⁶¹
- Criteria or specific requirement (including statutory, regulatory, or other citation)
- Condition⁶²
- Questioned costs⁶³
- Context⁶⁴
- Effect
- Cause
- Recommendation
- Views of responsible officials and planned corrective actions⁶⁵

⁵⁹ Paragraphs 13.36 and 13.40 and chapter 4 of this guide provide guidance on reporting views of responsible officials and planned corrective action.

⁶⁰ See footnote 57.

⁶¹ Provide the federal program (CFDA number and title) and agency, the federal award's number and year, and the name of the pass-through entity, if applicable. When this information is not available, provide the best information available to describe the federal award.

⁶² Include facts that support the deficiency identified in the audit finding.

⁶³ Identify questioned costs as required by Sections 510(a)(3) and 510(a)(4) of Circular A-133.

⁶⁴ See footnote 58.

⁶⁵ See footnote 59.

Chapter 14

Program-Specific Audits

Note: The audit required by the Single Audit Act Amendments of 1996 and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133), should be performed in accordance with *Government Auditing Standards*. Part I, "Government Auditing Standards Audits," (chapters 2–4 of this guide) discusses financial statement audits under generally accepted auditing standards and *Government Auditing Standards*. The guidance in parts I and II, "Circular A-133 Audits," (chapters 5–14 of this guide) is applicable for those auditors performing an audit under the Single Audit Act Amendments of 1996 and Circular A-133.

Information related to the American Recovery and Reinvestment Act of 2009 (Recovery Act) can be found in a section located at the end of each chapter in part II of this guide. See the section titled "American Recovery and Reinvestment Act Considerations" beginning at paragraph 14.17 in this chapter. See also the preface section titled "Impact of the American Recovery and Reinvestment Act of 2009 on Single Audits."

14.01 A program-specific audit¹ is an audit of an entity's compliance with direct and material² compliance requirements as they relate to an individual federal program (rather than a single audit, which includes an audit of an entity's financial statements and federal programs). Section 235 of the Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133), provides guidance on program-specific audits.

Use of a Program-Specific Audit to Satisfy Circular A-133 Audit Requirements

14.02 Section 200 of Circular A-133 states that when an auditee expends federal awards under only one federal program (excluding research and

¹ Statement on Auditing Standards (SAS) No. 117, *Compliance Audits* (AICPA, *Professional Standards*, vol. 1, AU sec. 801), is applicable when performing a program-specific compliance audit under Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133). (See the other chapters in part II of this guide for guidance found in SAS No. 117 that applies to all compliance audits, including program-specific audits.)

² SAS No. 117 defines *applicable compliance requirements* as the compliance requirements that are subject to the compliance audit. Section 500(d) Circular A-133 states that the auditor should determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that may have a direct and material effect on each of its major programs. Therefore, in a Circular A-133 compliance audit, the direct and material compliance requirements are those that are subject to audit. Accordingly, for the purpose of adapting SAS No. 117 to a Circular A-133 compliance audit in this chapter, the term *applicable* has been replaced by *direct and material* when referring to such compliance requirements, except when citing content from SAS No. 117.

development) and the federal program's laws, regulations, or grant agreements do not require a financial statement audit of the auditee, the auditee may elect to have a program-specific audit performed in accordance with Section 235 of the circular.³ Therefore, the auditor should determine whether there is a financial statement audit requirement before performing a program-specific audit. A program-specific audit may not be elected for research and development unless all federal awards expended were received from the same federal agency (or the same federal agency and the same pass-through entity) and that federal agency (or pass-through entity, in the case of a subrecipient) approves a program-specific audit in advance.

Program-Specific Audit Requirements

14.03 Circular A-133 states that program-specific audits are subject to the following sections of Circular A-133 as they may apply to program-specific audits, unless contrary to the provisions of Section 235 of Circular A-133, a federal program-specific audit guide, or the program's laws and regulations:

- Purpose, definitions, audit requirements, basis for determining the federal awards expended, subrecipient and vendor determinations, and relation to other audit requirements (Sections 100–215(b))
- Frequency of audits, sanctions, and audit costs (Sections 220–230)
- Auditee responsibilities and auditor selection (Sections 300–305)
- Follow-up on audit findings (Section 315)
- Submission of report (Sections 320(f)–320(j))
- Responsibilities of federal agencies and pass-through entities and management decisions (Sections 400–405)
- Audit findings and audit working papers (Sections 510–515)

Program-specific audits also are subject to other provisions, referred to in Section 235 of the Circular A-133.

Availability of Program-Specific Audit Guides

14.04 In many cases, a federal agency's Office of the Inspector General (OIG) will have issued a program-specific audit guide that provides guidance on internal control, compliance requirements, suggested audit procedures, and audit reporting requirements for a particular federal program. The auditor should contact the OIG of the federal agency to determine whether such a guide is available and current. When a current program-specific audit guide is available, the auditor should follow *Government Auditing Standards* and the guide when performing a program-specific audit. However, if there have been significant changes made to a program's compliance requirements and the related program-specific audit guide has not been updated with regard to the changes, the auditor should follow Section 235 of Circular A-133 and the *OMB Circular A-133 Compliance Supplement (Compliance Supplement)* in lieu of an

³ An example of a situation where a program-specific audit would not be allowed would be a not-for-profit college that receives student financial aid (SFA) (and no other federal awards). That is because the Higher Education Act of 1965, as amended, requires institutions that receive SFA to undergo an annual financial statement audit.

outdated guide. In addition, paragraph 22 of Statement on Auditing Standards (SAS) No. 117, *Compliance Audits* (AICPA, *Professional Standards*, vol. 1, AU sec. 801), notes that in instances in which audit guidance provided by a governmental agency for the performance of compliance audits has not been updated for, or otherwise conflicts with, current generally accepted auditing standards (GAAS) or *Government Auditing Standards*, the auditor should comply with the most current applicable professional standards and guidance instead of the outdated or conflicting guidance.

14.05 When a program-specific audit guide is not available, the auditee and the auditor have basically the same responsibilities for the federal program as they have for an audit of a major program in a Circular A-133 compliance audit as discussed in chapters 9, "Consideration of Internal Control Over Compliance for Major Programs," and 10, "Compliance Auditing Applicable to Major Programs," of this guide. (See also paragraph 14.07 for more information.)

Auditee's Responsibilities When a Program-Specific Audit Guide Is Not Available

14.06 In addition to the responsibilities included in the sections of Circular A-133 as described in paragraph 14.03, Circular A-133 states that when a program-specific audit guide is not available, auditees have the responsibility to prepare the following:

- The financial statements for the federal program, which include, at a minimum, a schedule of expenditures of federal awards for the program and notes that describe the significant accounting policies used in preparing the schedule (Chapter 7, "Schedule of Expenditures of Federal Awards," of this guide discusses the schedule.)
- A summary schedule of prior audit findings consistent with the requirements of Section 315(b) of Circular A-133 (See chapter 13, "Auditor Reporting Requirements and Other Communication Considerations in a Single Audit," of this guide.)
- If applicable, a corrective action plan consistent with the requirements of Section 315(c) of the Circular (See chapter 13 of this guide.)

Auditor's Responsibilities When a Program-Specific Audit Guide Is Not Available

Audit Scope and Requirements

14.07 When a program-specific audit guide is not available, Circular A-133 states that the auditor should do the following:

- Perform an audit of the financial statement(s) for the federal program in accordance with *Government Auditing Standards*. (Chapters 2, "Planning Considerations of *Government Auditing Standards*," 3, "Financial Statement Audit Considerations of *Government Auditing Standards*," and 4, "Auditor Reporting Requirements and Other Communication Considerations of *Government Auditing Standards*," of this guide provide guidance on financial

statement audits.) Paragraph 14.11 further discusses the *Government Auditing Standards* report.

- Obtain an understanding of the internal control over compliance and perform tests of the internal control over compliance for the federal program, so that they are consistent with the requirements of Section 500(c) of Circular A-133 for a major program. (Chapter 9 of this guide provides guidance on the internal control considerations for major programs.)
- Perform procedures to determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on the federal program consistent with the requirements of Section 500(d) of Circular A-133 for a major program. (Chapter 10 of this guide provides guidance on the compliance-auditing considerations for major programs.)
- Follow up on prior audit findings, perform procedures to assess the reasonableness of the summary schedule of prior audit findings that has been prepared by the auditee, and when the auditor concludes that the summary schedule of prior audit findings materially misrepresents the status of any prior audit finding, report this as a current-year audit finding, in accordance with the requirements of Section 500(e) of Circular A-133. (See chapter 13 of this guide.)

Auditor Procedures

14.08 Paragraph A11 of SAS No. 117 lists procedures the auditor may perform to identify and obtain an understanding of the applicable compliance requirements if the *Compliance Supplement* or a program-specific audit guide is not applicable:

- Reading the laws, regulations, rules, and provisions of contracts or grant agreements that pertain to the program
- Making inquiries of management and other knowledgeable entity personnel
- Making inquiries of appropriate individuals outside the entity, such as (a) the office of the federal, state, or local program official or auditor or other appropriate audit oversight organizations or regulators, about the laws and regulations applicable to entities within their jurisdiction, including statutes and uniform reporting requirements or (b) a third party specialist, such as an attorney
- Reading the minutes of meetings of the governing board of the entity being audited
- Reading audit documentation about the applicable compliance requirements prepared during prior years' audits or other engagements
- Discussing applicable compliance requirements with auditors who performed prior years' audits or other engagements

The procedures in the preceding list also may assist the auditor in obtaining a further understanding of the applicable compliance requirements for those engagements when the *Compliance Supplement* or program-specific audit guide is available.

Auditor's Reports⁴

Circular A-133 Requirements

14.09 Circular A-133 states that the auditor's reports may be in the form of either combined or separate reports and may be organized differently from the manner described in Circular A-133 and as listed in this paragraph. The auditor's reports should state that the audit was conducted in accordance with Circular A-133. Because the audit is also subject to GAAS reporting requirements and *Government Auditing Standards*, the report should also include a reference to auditing standards generally accepted in the United States of America and *Government Auditing Standards*. The auditor's reports should include the following:

- An opinion (or disclaimer of opinion) on whether the financial statement(s) of the federal program are presented fairly in all material respects in conformity with the stated accounting policies
- A report on the internal control related to the federal program, which should describe the scope of the testing of the internal control and the results of the tests
- A report on compliance, which includes an opinion (or a disclaimer of opinion) on whether the auditee complied with laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on the federal program
- A schedule of findings and questioned costs for the federal program that includes a summary of the auditor's results relative to the audit of the federal program in a format consistent with the requirements for the summary of auditor's results in Section 505(d)(1) of Circular A-133, as well as findings and questioned costs for federal awards consistent with the requirements of Section 505(d)(3) of the circular (See chapter 13 of this guide.)⁵

Recommended Auditor's Reports

14.10 In an effort to make program-specific audit reporting understandable and to reduce the number of reports issued, this guide recommends that the following reports be issued for a program-specific audit: (a) an opinion (or disclaimer of opinion) on the financial statement(s) of the federal program, and (b) a report on compliance with requirements that could have a direct and material effect on the federal program and on the internal control over compliance in accordance with the program-specific audit option under Circular A-133. Paragraph 14.11 discusses the possible issuance of a third report to meet the reporting requirements of *Government Auditing Standards*. Appendix A (paragraph 14.18) illustrates program-specific audit reports. Chapters 4 and 13 of this guide discuss the *Government Auditing Standards* requirement that the auditor communicate certain matters to officials of the audited entity in writing.

⁴ See also chapter 13, "Auditor Reporting Requirements and Other Communication Considerations in a Single Audit," for a discussion of the basic elements of the auditor's reports.

⁵ As discussed in chapter 13 of this guide, the schedule of findings and questioned costs also should meet the presentation requirements of *Government Auditing Standards* and report the views of responsible officials concerning the findings, conclusions, and recommendations, as well as planned corrective actions.

Reporting in Accordance With Government Auditing Standards

14.11 If the financial statement(s) of the program present only the activity of the federal program, the auditor is not required to issue a separate report to meet the reporting requirements of *Government Auditing Standards*. This is because, in many cases, by definition, the financial statements of the program consist only of the schedule of expenditures of federal awards. In this situation, the program-specific audit reports in appendix A (paragraph 14.18) would meet the financial, compliance, and internal control over compliance reporting requirements of both *Government Auditing Standards* and Circular A-133. However, the auditor always has the option of issuing a separate *Government Auditing Standards* report (in addition to the two reports described in paragraph 14.10). In situations when the auditor is engaged to perform a separate engagement, in addition to the program-specific audit (for example, a financial statement audit in accordance with *Government Auditing Standards*), the appropriate audit reports should be issued including a separate *Government Auditing Standards* report. Chapter 4 in this guide discusses the *Government Auditing Standards* report and appendix A in chapter 4 illustrates the *Government Auditing Standards* report.

Evaluating and Reporting Abuse

14.12 Chapters 9–10 and 13 of this guide discuss the *Government Auditing Standards* requirements for evaluating and reporting abuse in an audit in accordance with Circular A-133. Auditors who report abuse findings should consider the need to modify the auditor's reports to refer to those findings.

Submission of Report*

Timing of Submission

14.13 Circular A-133 states that the audit should be completed and the reporting required by Sections 235(c)(2) and 235(c)(3) of the circular be submitted within the earlier of 30 days after the receipt of the auditor's reports or 9 months after the end of the audit period, unless a longer period is agreed to in advance by the federal agency that provided the funding or unless a different period is specified in a program-specific audit guide. Circular A-133 also states that unless restricted by law or regulation, the auditee should make copies of the report available for public inspection.

Submission When a Program-Specific Audit Guide Is Available

14.14 When a program-specific audit guide is available, the auditee should submit to the Federal Audit Clearinghouse (FAC) the data collection form (DCF) prepared in accordance with Section 320(b) of the circular, as applicable for a

* In March 2010, the OMB advised federal agencies in a memorandum titled "Updated Guidance on the American Recovery and Reinvestment Act (M-10-14)" that they should not grant any extension requests to grantees for fiscal years 2009–2011. Appendix 7, "Other Circular A-133 Advisories," of the 2010 *OMB Circular A-133 Compliance Supplement (Compliance Supplement)* is expected to emphasize this point and note that federal agencies have either already adopted this policy or are in the process of adopting it. (At the time of this writing, the *Compliance Supplement* is expected to include this information related to extension requests. It is important that readers be alert to final issuance of the *Compliance Supplement*, which will be available on the OMB website at www.whitehouse.gov/omb/grants/circulars/.)

program-specific audit, and also submit the reporting that is required by the program-specific audit guide. (Chapter 13 of this guide provides guidance on the FAC and the completion and submission of the DCF.) The auditee also should submit any reporting required by the program-specific audit guide to the federal awarding agency or pass-through entity. (See also paragraph 14.16).

Submission When a Program-Specific Audit Guide Is Not Available

14.15 When a program-specific audit guide is not available, the reporting package for a program-specific audit consists of the following:

- The financial statement(s) of the federal program
- A summary schedule of prior audit findings (See chapter 13 of this guide.)
- A corrective action plan (See chapter 13 of this guide.)
- The auditor's report(s) described in paragraphs 14.09–.11

14.16 Circular A-133 states that the auditee should submit the DCF, as applicable to a program-specific audit, and the reporting package to the FAC, as discussed in chapter 13 of this guide. When a subrecipient is not required to submit a reporting package to the pass-through entity, the subrecipient should provide written notification to the pass-through entity, consistent with the requirements of Section 320(e)(2) of Circular A-133, as discussed in chapter 13 of this guide. A subrecipient may submit a copy of the reporting package to the pass-through entity to comply with the notification requirement.

American Recovery and Reinvestment Act Considerations[†]

14.17 Additional requirements related to expenditures of the Recovery Act funds may impact a program-specific audit. Recovery Act guidance specifies that any additional terms and conditions beyond standard practice must be included in Recovery Act award terms and conditions. In addition, program-specific audit guidance may contain additional guidance related to the expenditure of Recovery Act funds.

[†] Information in this guide related to the American Recovery and Reinvestment Act of 2009 (Recovery Act) is based upon the latest information available at the time of this writing. However, this information is subject to change because guidance from the OMB is being issued and updated on an ongoing basis. It is important for recipients of Recovery Act funding, and their auditors, to monitor the guidance issued. For the latest OMB guidance, go to the OMB website at www.whitehouse.gov/omb/recovery/default. Information can also be found at the Recovery Act Resource Center on the Governmental Audit Quality Center website, which is open to the public at www.aicpa.org/INTERESTAREAS/GOVERNMENTALAUDITQUALITY/RESOURCES/RECOVERYACTRESOURCECENTER/Pages/default.aspx and at the U.S. Government's official Recovery Act website at www.recovery.gov.

Appendix A—Illustrative Auditor’s Reports
for Program-Specific Audits

The illustrative reports in this appendix are examples of the reports issued under Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, for a program-specific audit. These reports are based on Statement on Auditing Standard (SAS) No. 115, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 325), and have been updated for the guidance in SAS No. 117, *Compliance Audits* (AICPA, *Professional Standards*, vol. 1, AU sec. 801). The following table lists the illustrative reports. Auditors should exercise professional judgment in any situation not specifically addressed in these illustrations. (As discussed in paragraph 14.11, the auditor should, in certain circumstances, issue these program-specific audit reports as well as a separate *Government Auditing Standards* report. Appendix A in chapter 4, "Auditor Reporting Requirements and Other Communication Considerations of Government Auditing Standards," of this guide illustrates the *Government Auditing Standards* report.)

| <i>Example No.</i> | <i>Title</i> |
|--------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 14-1 | Unqualified Opinion on the Financial Statement of a Federal Program in Accordance With the Program-Specific Audit Option Under OMB Circular A-133 |
| 14-2 | Report on Compliance with Requirements That Could Have a Direct and Material Effect on the Federal Program and on Internal Control Over Compliance in Accordance With the Program-Specific Audit Option Under OMB Circular A-133 (<i>Unqualified Opinion on Compliance; No Material Weaknesses or Significant Deficiencies in Internal Control Over Compliance Identified</i>) |

Example 14-1

Unqualified Opinion on the Financial Statement of a Federal Program in Accordance With the Program-Specific Audit Option Under OMB Circular A-133

Independent Auditor's Report

We have audited the accompanying schedule of expenditures of federal awards for the [identify the federal program] of Example Entity for the year ended June 30, 20X1. This financial statement is the responsibility of Example Entity's management. Our responsibility is to express an opinion on the financial statement of the program based on our audit.¹

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*,² issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the schedule of expenditures of federal awards referred to above³ presents fairly, in all material respects, the expenditures of federal awards under the [identify the federal program] in conformity with accounting principles generally accepted in the United States of America.^{4,5}

[Signature]

[Date]

¹ In many cases, the financial statements of the program consist only of the schedule of expenditures of federal awards (and notes to the schedule), which is the minimum financial statement presentation required by Section 235 of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. If the auditee issues financial statements that consist of more than the schedule, this paragraph would be modified to describe the financial statements. Paragraph 14.11 discusses the possible need to issue a separate report to meet the reporting requirements of *Government Auditing Standards*.

² The standards applicable to financial audits are the general, fieldwork, and reporting standards described in chapters 3–5 of *Government Auditing Standards*.

³ If the auditee issues financial statements that consist of more than the schedule, this sentence should be modified to identify the results displayed in the financial presentation.

⁴ AU section 623, *Special Reports* (AICPA, *Professional Standards*, vol. 1), provides requirements and guidance when the auditee prepares the financial statement of the program in conformity with a basis of accounting other than generally accepted accounting principles.

⁵ If a separate report is issued to meet the reporting requirements of *Government Auditing Standards* (see paragraph 14.11), an additional paragraph would be added after the opinion paragraph as follows:

In accordance with *Government Auditing Standards*, we have also issued our report dated [date of report] on our consideration of Example Entity's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide opinions on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The second sentence of this paragraph should be modified if the auditor is providing an opinion on internal control over financial reporting or on compliance.

Example 14-2

Report on Compliance With Requirements That Could Have a Direct and Material* Effect on the Federal Program and on Internal Control Over Compliance in Accordance With the Program-Specific Audit Option Under OMB Circular A-133⁶ (Unqualified Opinion on Compliance; No Material Weaknesses or Significant Deficiencies in Internal Control Over Compliance Identified)⁷

[Addressee]

Compliance⁸

We have audited Example Entity's compliance with the types of compliance requirements⁹ described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on its [identify the federal program] for the year ended June 30, 20X1. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is

* Statement on Auditing Standards (SAS) No. 117, *Compliance Audits* (AICPA, *Professional Standards*, vol. 1, AU sec. 801), defines *applicable compliance requirements* as the compliance requirements that are subject to the compliance audit. According to Section 505 of Circular A-133, the auditor's report on compliance with laws, regulations, and the provisions of contracts or grant agreements should include an opinion (or disclaimer of opinion) as to whether the auditee complied with laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on each major program. Therefore, in a Circular A-133 compliance audit, the applicable compliance requirements, as the term is used in SAS No. 117, are those that could have a direct and material effect on a major program. Accordingly, for the purpose of adapting SAS No. 117 to a Circular A-133 compliance audit, the term *applicable* has been replaced by *direct and material* when referencing such compliance requirements in this report. See also footnote 9 of this appendix for a discussion related to the determination of material noncompliance.

⁶ This is an example of a report on a program-specific audit under Circular A-133 when no federal audit guide applicable to the program being audited is available. When a federal audit guide applicable to the program is available, Circular A-133 requires that the auditor follow the reporting requirement of that federal audit guide. (Paragraph 14.04 discusses the auditor's responsibility when a program-specific audit guide is not current.)

⁷ If issuing a qualified or adverse opinion on compliance, the auditor may modify the compliance opinion section of this report. Additionally, if reporting significant deficiencies or material weaknesses, the auditor also may modify the internal control section of this report. The portions of examples 13-2-13-5 in appendix A in chapter 13, "Auditor Reporting Requirements and Other Communication Considerations in a Single Audit," of this guide that apply to a specific auditee situation in a single audit may be useful in modifying this report. See also paragraph 14.12 concerning the need to modify this report if the schedule of finding and questions costs includes abuse findings.

⁸ This report sequences the reporting on compliance before the reporting on internal control over compliance. However, the *Government Auditing Standards* reports in appendix A in chapter 4, "Auditor Reporting Requirements and Other Communication Considerations of *Government Auditing Standards*," of this guide sequence the reporting on internal control over financial reporting before the reporting on compliance and other matters. Auditors may present the internal control over compliance and compliance sections of Circular A-133 and *Government Auditing Standards* reports in whichever sequence better meets their needs.

⁹ Under Section 510(a) of Circular A-133, the auditor's determination of whether a noncompliance with the provisions of laws, regulations, contracts, or grant agreements is material for the purpose of reporting an audit finding is in relation to a type of compliance requirement for a major program or an audit objective identified in the *OMB Circular A-133 Compliance Supplement* (*Compliance Supplement*). Further, the auditor's determination of whether a deficiency in internal control over compliance is a material weakness or significant deficiency for the purpose of reporting an audit finding is also in relation to a type of compliance requirement for a major program or an audit objective identified in the *Compliance Supplement*. This reference to *type of compliance requirements* used here and elsewhere in this report illustration refers to the 14 types of compliance requirements (identified as "A" through "N") described in Part 3 of the *Compliance Supplement*. For purposes of reporting audit findings, auditors are alerted that certain of the types of compliance requirements may include multiple compliance requirements with multiple audit objectives (for example, compliance requirement "G" covers three separate requirements—matching, level of effort, and earmarking; and "N" covers separate requirements specific to each individual special test and provision).

the responsibility of Example Entity's management. Our responsibility is to express an opinion on Example Entity's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*,¹⁰ issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on [identify the federal program] occurred. An audit includes examining, on a test basis, evidence about Example Entity's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Example Entity's compliance with those requirements.

In our opinion, Example Entity complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its [identify the federal program] for the year ended June 30, 20X1. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items [list the reference numbers of the related findings, for example, 20X1-1 and 20X1-2].¹¹

Internal Control Over Compliance

Management of Example Entity is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Example Entity's internal control over compliance with the requirements that could have a direct and material effect on its [identify the federal program] to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Example Entity's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to

¹⁰ See footnote 2.

¹¹ When there are no such instances of noncompliance identified in the schedule of findings and questioned costs, the last sentence would be omitted.

identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

Example Entity's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit Example Entity's responses and, accordingly, we express no opinion on the responses.^{12,13}

This report is intended solely for the information and use of management, [*identify the body or individuals charged with governance*], others within the entity, [*identify the legislative or regulatory body*], the federal awarding agency, and the pass-through entity and is not intended to be and should not be used by anyone other than these specified parties.¹⁴

[Signature]

[Date]

¹² If, as noted in footnote 11, there are no findings referred to in this report (or identified in the schedule of findings and questioned costs), this paragraph would be omitted.

¹³ Although the auditor does not audit management's responses to identified findings, the auditor does have certain responsibilities related to reporting the views of responsible officials under *Government Auditing Standards*. As noted in paragraph 5.32 of *Government Auditing Standards*, auditors should obtain and report the views of responsible officials concerning the findings, conclusions, and recommendations, as well as planned corrective actions. See paragraph 13.36 for further information.

¹⁴ This paragraph conforms to AU section 532, *Restricting the Use of an Auditor's Report* (AICPA, *Professional Standards*, vol. 1). See AU section 532 for additional guidance on restricted-use reports.

Appendix A

Single Audit Act Amendments of 1996

Public Law 104-156
104th Congress

An Act

July 5, 1996
[S. 1579]

To streamline and improve the effectiveness of chapter 75 of title 31, United States Code (commonly referred to as the "Single Audit Act").

Single Audit Act
Amendments
of 1996.
31 USC 7501
note.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; PURPOSES.

(a) Short Title—This Act may be cited as the ASingle Audit Act Amendments of 1996".

(b) Purposes—The purposes of this Act are to—

(1) promote sound financial management, including effective internal controls, with respect to Federal awards administered by non-Federal entities;

(2) establish uniform requirements for audits of Federal awards administered by non-Federal entities;

(3) promote the efficient and effective use of audit resources;

(4) reduce burdens on State and local governments, Indian tribes, and nonprofit organizations; and

(5) ensure that Federal departments and agencies, to the maximum extent practicable, rely upon and use audit work done pursuant to chapter 75 of title 31, United States Code (as amended by this Act).

SEC. 2 . AMENDMENT TO TITLE 31, UNITED STATES CODE.

Chapter 75 of title 31, United States Code, is amended to read as follows:

"CHAPTER 75—REQUIREMENTS FOR SINGLE AUDITS

"Sec.

"7501. Definitions.

"7502. Audit requirements; exemptions.

"7503. Relation to other audit requirements.

"7504. Federal agency responsibilities and relations with non-Federal entities.

"7505. Regulations.

"7506. Monitoring responsibilities of the Comptroller General.

"7507. Effective date.

"§ 7501. Definitions

"(a) As used in this chapter, the term—

"(1) 'Comptroller General' means the Comptroller General of the United States;

"(2) 'Director' means the Director of the Office of Management and Budget;

"(3) 'Federal agency' has the same meaning as the term 'agency' in section 551(1) of title 5;

"(4) 'Federal awards' means Federal financial assistance and Federal cost-reimbursement contracts that non-Federal entities receive directly from Federal awarding agencies or indirectly from pass-through entities;

"(5) 'Federal financial assistance' means assistance that non-Federal entities receive or administer in the form of grants, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, or other assistance, but does not include amounts received as reimbursement for services rendered to individuals in accordance with guidance issued by the Director;

"(6) 'Federal program' means all Federal awards to a non-Federal entity assigned a single number in the Catalog of Federal Domestic Assistance or encompassed in a group of numbers or other category as defined by the Director;

"(7) 'generally accepted government auditing standards' means the government auditing standards issued by the Comptroller General;

"(8) 'independent auditor' means—

"(A) an external State or local government auditor who meets the independence standards included in generally accepted government auditing standards; or

"(B) a public accountant who meets such independence standards;

"(9) 'Indian tribe' means any Indian tribe, band, nation, or other organized group or community, including any Alaskan Native village or regional or village corporation (as defined in, or established under, the Alaskan Native Claims Settlement Act) that is recognized by the United States as eligible for the special programs and services provided by the United States to Indians because of their status as Indians;

"(10) 'internal controls' means a process, effected by an entity's management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

"(A) Effectiveness and efficiency of operations.

"(B) Reliability of financial reporting.

"(C) Compliance with applicable laws and regulations;

"(11) 'local government' means any unit of local government within a State, including a county, borough, municipality, city, town, township, parish, local public authority, special district, school district, intrastate district, council of governments, any other instrumentality of local government and, in accordance with guidelines issued by the Director, a group of local governments;

"(12) 'major program' means a Federal program identified in accordance with risk-based criteria prescribed by the Director under this chapter, subject to the limitations described under subsection (b);

"(13) 'non-Federal entity' means a State, local government, or nonprofit organization;

"(14) 'nonprofit organization' means any corporation, trust, association, cooperative, or other organization that—

"(A) is operated primarily for scientific, educational, service, charitable, or similar purposes in the public interest;

"(B) is not organized primarily for profit; and

"(C) uses net proceeds to maintain, improve, or expand the operations of the organization;

"(15) 'pass-through entity' means a non-Federal entity that provides Federal awards to a subrecipient to carry out a Federal program;

"(16) 'program-specific audit' means an audit of one Federal program;

"(17) 'recipient' means a non-Federal entity that receives awards directly from a Federal agency to carry out a Federal program;

"(18) 'single audit' means an audit, as described under section 7502(d), of a non-Federal entity that includes the entity's financial statements and Federal awards;

"(19) 'State' means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, American

Samoa, the Commonwealth of the Northern Mariana Islands, and the Trust Territory of the Pacific Islands, any instrumentality thereof, any multi-State, regional, or interstate entity which has governmental functions, and any Indian tribe; and

"(20) 'subrecipient' means a non-Federal entity that receives Federal awards through another non-Federal entity to carry out a Federal program, but does not include an individual who receives financial assistance through such awards.

"(b) In prescribing risk-based program selection criteria for major programs, the Director shall not require more programs to be identified as major for a particular non-Federal entity, except as prescribed under subsection (c) or as provided under subsection (d), than would be identified if the major programs were defined as any program for which total expenditures of Federal awards by the non-Federal entity during the applicable year exceed—

"(1) the larger of \$30,000,000 or 0.15 percent of the non-Federal entity's total Federal expenditures, in the case of a non-Federal entity for which such total expenditures for all programs exceed \$10,000,000,000;

"(2) the larger of \$3,000,000, or 0.30 percent of the non-Federal entity's total Federal expenditures, in the case of a non-Federal entity for which such total expenditures for all programs exceed \$100,000,000 but are less than or equal to \$10,000,000,000; or

"(3) the larger of \$300,000, or 3 percent of such total Federal expenditures for all programs, in the case of a non-Federal entity for which such total expenditures for all programs equal or exceed \$300,000 but are less than or equal to \$100,000,000.

"(c) When the total expenditures of a non-Federal entity's major programs are less than 50 percent of the non-Federal entity's total expenditures of all Federal awards (or such lower percentage as specified by the Director), the auditor shall select and test additional programs as major programs as necessary to achieve audit coverage of at least 50 percent of Federal expenditures by the non-Federal entity (or such lower percentage as specified by the Director), in accordance with guidance issued by the Director.

"(d) Loan or loan guarantee programs, as specified by the Director, shall not be subject to the application of subsection (b).

"§ 7502. Audit requirements; exemptions

"(a)(1)(A) Each non-Federal entity that expends a total amount of Federal awards equal to or in excess of \$300,000 or such other amount specified by the Director under subsection (a)(3) in any fiscal year of such non-Federal entity shall have either a single audit or a program-specific audit made for such fiscal year in accordance with the requirements of this chapter.

(B) Each such non-Federal entity that expends Federal awards under more than one Federal program shall undergo a single audit in accordance with the requirements of subsections (b) through (i) of this section and guidance issued by the Director under section 7505.

"(C) Each such non-Federal entity that expends awards under only one Federal program and is not subject to laws, regulations, or Federal award agreements that require a financial statement audit of the non-Federal entity, may elect to have a program-specific audit conducted in accordance with applicable provisions of this section and guidance issued by the Director under section 7505.

(2)(A) Each non-Federal entity that expends a total amount of Federal awards of less than \$300,000 or such other amount specified by the Director under subsection (a)(3) in any fiscal year of such entity, shall be exempt for such fiscal year from compliance with

(i) the audit requirements of this chapter; and

(ii) any applicable requirements concerning financial audits contained in Federal statutes and regulations governing programs under which such Federal awards are provided to that non-Federal entity.

"(B) The provisions of subparagraph (A)(ii) of this paragraph shall not exempt a non-Federal entity from compliance with any provision of a Federal statute or regulation that requires such non-Federal entity to maintain records concerning Federal awards provided to such non-Federal entity or that permits a Federal agency, pass-through entity, or the Comptroller General access to such records.

"(3) Every 2 years, the Director shall review the amount for requiring audits prescribed under paragraph (1)(A) and may adjust such dollar

amount consistent with the purposes of this chapter, provided the Director does not make such adjustments below \$300,000.

"(b)(1) Except as provided in paragraphs (2) and (3), audits conducted pursuant to this chapter shall be conducted annually.

"(2) A State or local government that is required by constitution or statute, in effect on January 1, 1987, to undergo its audits less frequently than annually, is permitted to undergo its audits pursuant to this chapter biennially. Audits conducted biennially under the provisions of this paragraph shall cover both years within the biennial period.

"(3) Any nonprofit organization that had biennial audits for all biennial periods ending between July 1, 1992, and January 1, 1995, is permitted to undergo its audits pursuant to this chapter biennially. Audits conducted biennially under the provisions of this paragraph shall cover both years within the biennial period.

"(c) Each audit conducted pursuant to subsection (a) shall be conducted by an independent auditor in accordance with generally accepted government auditing standards, except that, for the purposes of this chapter, performance audits shall not be required except as authorized by the Director.

"(d) Each single audit conducted pursuant to subsection (a) for any fiscal year shall

"(1) cover the operations of the entire non-Federal entity;
or

"(2) at the option of such non-Federal entity such audit shall include a series of audits that cover departments, agencies, and other organizational units which expended or otherwise administered Federal awards during such fiscal year provided that each such audit shall encompass the financial statements and schedule of expenditures of Federal awards for each such department, agency, and organizational unit, which shall be considered to be a non-Federal entity.

"(e) The auditor shall—

"(1) determine whether the financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles;

"(2) determine whether the schedule of expenditures of Federal awards is presented fairly

in all material respects in relation to the financial statements taken as a whole;

"(3) with respect to internal controls pertaining to the compliance requirements for each major program—

"(A) obtain an understanding of such internal controls;

"(B) assess control risk; and

"(C) perform tests of controls unless the controls are deemed to be ineffective; and

"(4) determine whether the non-Federal entity has complied with the provisions of laws, regulations, and contracts or grants pertaining to Federal awards that have a direct and material effect on each major program.

"(f)(1) Each Federal agency which provides Federal awards to a recipient shall—

"(A) provide such recipient the program names (and any identifying numbers) from which such awards are derived, and the Federal requirements which govern the use of such awards and the requirements of this chapter; and

"(B) review the audit of a recipient as necessary to determine whether prompt and appropriate corrective action has been taken with respect to audit findings, as defined by the Director, pertaining to Federal awards provided to the recipient by the Federal agency.

"(2) Each pass-through entity shall—

"(A) provide such subrecipient the program names (and any identifying numbers) from which such assistance is derived, and the Federal requirements which govern the use of such awards and the requirements of this chapter;

"(B) monitor the subrecipient's use of Federal awards through site visits, limited scope audits, or other means;

"(C) review the audit of a subrecipient as necessary to determine whether prompt and appropriate corrective action has been taken with respect to audit findings, as defined by the Director, pertaining to Federal awards provided to the subrecipient by the pass-through entity; and

"(D) require each of its subrecipients of Federal awards to permit, as a condition of receiving Federal awards, the independent auditor of the

pass-through entity to have such access to the subrecipient's records and financial statements as may be necessary for the pass-through entity to comply with this chapter.

"(g)(1) The auditor shall report on the results of any audit conducted pursuant to this section, in accordance with guidance issued by the Director.

"(2) When reporting on any single audit, the auditor shall include a summary of the auditor's results regarding the non-Federal entity's financial statements, internal controls, and compliance with laws and regulations.

"(h) The non-Federal entity shall transmit the reporting package, which shall include the non-Federal entity's financial statements, schedule of expenditures of Federal awards, corrective action plan defined under subsection (i), and auditor's reports developed pursuant to this section, to a Federal clearinghouse designated by the Director, and make it available for public inspection within the earlier of C

"(1) 30 days after receipt of the auditor's report; or

"(2)(A) for a transition period of at least 2 years after the effective date of the Single Audit Act Amendments of 1996, as established by the Director, 13 months after the end of the period audited; or

(B) for fiscal years beginning after the period specified in subparagraph (A), 9 months after the end of the period audited, or within a longer time frame authorized by the Federal agency, determined under criteria issued under section 7504, when the 9-month time frame would place an undue burden on the non-Federal entity.

"(i) If an audit conducted pursuant to this section discloses any audit findings, as defined by the Director, including material noncompliance with individual compliance requirements for a major program by, or reportable conditions in the internal controls of, the non-Federal entity with respect to the matters described in subsection (e), the non-Federal entity shall submit to Federal officials designated by the Director, a plan for corrective action to eliminate such audit findings or reportable conditions or a statement describing the reasons that corrective action is not necessary. Such plan shall be consistent with the audit resolution standard promulgated by the Comptroller General (as part of the standards for internal controls in the Federal Government) pursuant to section 3512(c).

"(j) The Director may authorize pilot projects to test alternative methods of achieving the purposes of this chapter. Such pilot projects may begin only after consultation with the Chair and Ranking Minority Member of the Committee on Governmental Affairs of the Senate and the Chair and Ranking Minority Member of the Committee on Government Reform and Oversight of the House of Representatives.

"§ 7503. Relation to other audit requirements

"(a) An audit conducted in accordance with this chapter shall be in lieu of any financial audit of Federal awards which a non-Federal entity is required to undergo under any other Federal law or regulation. To the extent that such audit provides a Federal agency with the information it requires to carry out its responsibilities under Federal law or regulation, a Federal agency shall rely upon and use that information.

"(b) Notwithstanding subsection (a), a Federal agency may conduct or arrange for additional audits which are necessary to carry out its responsibilities under Federal law or regulation. The provisions of this chapter do not authorize any non-Federal entity (or subrecipient thereof) to constrain, in any manner, such agency from carrying out or arranging for such additional audits, except that the Federal agency shall plan such audits to not be duplicative of other audits of Federal awards.

"(c) The provisions of this chapter do not limit the authority of Federal agencies to conduct, or arrange for the conduct of, audits and evaluations of Federal awards, nor limit the authority of any Federal agency Inspector General or other Federal official.

"(d) Subsection (a) shall apply to a non-Federal entity which undergoes an audit in accordance with this chapter even though it is not required by section 7502(a) to have such an audit.

"(e) A Federal agency that provides Federal awards and conducts or arranges for audits of non-Federal entities receiving such awards that are in addition to the audits of non-Federal entities conducted pursuant to this chapter shall, consistent with other applicable law, arrange for funding the full cost of such additional audits. Any such additional audits shall be coordinated with the Federal agency determined under criteria issued under section 7504 to preclude duplication of the audits conducted pursuant to this chapter or other additional audits.

"(f) Upon request by a Federal agency or the Comptroller General, any independent auditor conducting an audit pursuant to this chapter shall

make the auditor's working papers available to the Federal agency or the Comptroller General as part of a quality review, to resolve audit findings, or to carry out oversight responsibilities consistent with the purposes of this chapter. Such access to auditor's working papers shall include the right to obtain copies.

"§ 7504. Federal agency responsibilities and relations with non-Federal entities

"(a) Each Federal agency shall, in accordance with guidance issued by the Director under section 7505, with regard to Federal awards provided by the agency—

"(1) monitor non-Federal entity use of Federal awards, and

"(2) assess the quality of audits conducted under this chapter for audits of entities for which the agency is the single Federal agency determined under subsection (b).

"(b) Each non-Federal entity shall have a single Federal agency, determined in accordance with criteria established by the Director, to provide the non-Federal entity with technical assistance and assist with implementation of this chapter.

"(c) The Director shall designate a Federal clearinghouse to—

"(1) receive copies of all reporting packages developed in accordance with this chapter;

"(2) identify recipients that expend \$300,000 or more in Federal awards or such other amount specified by the Director under section 7502(a)(3) during the recipient's fiscal year but did not undergo an audit in accordance with this chapter; and

"(3) perform analyses to assist the Director in carrying out responsibilities under this chapter.

"§ 7505. Regulations

"(a) The Director, after consultation with the Comptroller General, and appropriate officials from Federal, State, and local governments and nonprofit organizations shall prescribe guidance to implement this chapter. Each Federal agency shall promulgate such amendments to its regulations as may be necessary to conform such regulations to the requirements of this chapter and of such guidance.

"(b)(1) The guidance prescribed pursuant to subsection (a) shall include criteria for determining the appropriate charges to Federal awards for the cost of audits. Such criteria shall prohibit a non-Federal entity from charging to any Federal awards—

"(A) the cost of any audit which is—

"(i) not conducted in accordance with this chapter;

or

"(ii) conducted in accordance with this chapter when expenditures of Federal awards are less than amounts cited in section 7502(a)(1)(A) or specified by the Director under section 7502(a)(3), except that the Director may allow the cost of limited scope audits to monitor subrecipients in accordance with section 7502(f)(2)(B); and

"(B) more than a reasonably proportionate share of the cost of any such audit that is conducted in accordance with this chapter.

"(2) The criteria prescribed pursuant to paragraph (1) shall not, in the absence of documentation demonstrating a higher actual cost, permit the percentage of the cost of audits performed pursuant to this chapter charged to Federal awards, to exceed the ratio of total Federal awards expended by such non-Federal entity during the applicable fiscal year or years, to such non-Federal entity's total expenditures during such fiscal year or years.

"(c) Such guidance shall include such provisions as may be necessary to ensure that small business concerns and business concerns owned and controlled by socially and economically disadvantaged individuals will have the opportunity to participate in the performance of contracts awarded to fulfill the audit requirements of this chapter.

"§ 7506. Monitoring responsibilities of the Comptroller General

"(a) The Comptroller General shall review provisions requiring financial audits of non-Federal entities that receive Federal awards that are contained in bills and resolutions reported by the committees of the Senate and the House of Representatives.

"(b) If the Comptroller General determines that a bill or resolution contains provisions that are inconsistent with the requirements of this chapter, the Comptroller General shall, at the earliest practicable date, notify in writing—

"(1) the committee that reported such bill or resolution; and

"(2)(A) the Committee on Governmental Affairs of the Senate (in the case of a bill or resolution reported by a committee of the Senate); or

"(B) the Committee on Government Reform and Oversight of the House of Representatives (in the case of a bill or resolution reported by a committee of the House of Representatives).

"§ 7507. Effective date

"This chapter shall apply to any non-Federal entity with respect to any of its fiscal years which begin after June 30, 1996."

31 USC 7501
note.

SEC. 3. TRANSITIONAL APPLICATION

Subject to section 7507 of title 31, United States Code (as amended by section 2 of this Act) the provisions of chapter 75 of such title (before amendment by section 2 of this Act) shall continue to apply to any State or local government with respect to any of its fiscal years beginning before July 1, 1996.

Approved July 5, 1996.

LEGISLATIVE HISTORY—S. 1579 (H.R. 3184)

HOUSE REPORTS: No. 104—607 accompanying H.R. 3184 (Comm. on Government Reform and Oversight).

SENATE REPORTS: No. 104—266 (Comm. On Governmental Affairs).

CONGRESSIONAL RECORD, Vol. 142 (1996):
June 14, considered and passed Senate.
June 18, considered and passed House.

WEEKLY COMPILATION OF PRESIDENTIAL
DOCUMENTS, Vol. 32 (1996):
July 5, Presidential statement.

Appendix B

OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations

Circular No. A-133, revised to show changes published in the Federal Register June 27, 2003 and June 26, 2007

Audits of States, Local Governments, and Non-Profit Organizations

Accompanying *Federal Register* Materials:

- Audits of States, Local Governments, and Non-Profit Organizations June 30, 1997
 - Revision published June 27, 2003. This revision (1) increased the dollar threshold for the audit requirement; and (2) made changes regarding determination of cognizant and oversight agencies for audit.
 - Revision published June 26, 2007. This revision (1) replaced the term *reportable conditions* with *significant deficiencies* to conform with current auditing standards; and (2) updated report submission requirements. Definition of *significant deficiencies* and *material weaknesses* are as defined in generally accepted auditing standards issued by the American Institute of Certified Public Accountants (AICPA) and *Government Auditing Standards* issued by the Government Accountability Office.

Note: The June 27, 2003 revisions (1) increased the dollar threshold for the audit requirement, and (2) made changes regarding determination of cognizant and oversight agencies for audit. The June 26, 2007 revisions make changes to (1) to replace the terms *reportable conditions* with *significant deficiencies* to conform with changes in auditing standards; and (2) reporting submission requirements.

In several places, the Circular includes guidelines for the reporting of *significant deficiencies* and *material weaknesses*. These terms are to be used as defined in generally accepted auditing standards issued by the American Institute of Certified Public Accountants (AICPA), and *Government Auditing Standards* issued by the Government Accountability Office.

To the Heads of Executive Departments and Establishments

SUBJECT: Audits of States, Local Governments, and Non-Profit Organizations

1. Purpose. This Circular is issued pursuant to the Single Audit Act of 1984, P.L. 98-502, and the Single Audit Act Amendments of 1996, P.L. 104-156. It sets forth standards for obtaining consistency and uniformity among Federal agencies for the audit of States, local governments, and non-profit organizations expending Federal awards.

2. Authority. Circular A-133 is issued under the authority of sections 503, 1111, and 7501 et seq. of title 31, United States Code, and Executive Orders 8248 and 11541.

3. Rescission and Supersession. This Circular rescinds Circular A-128, "Audits of State and Local Governments," issued April 12, 1985, and supersedes the prior Circular A-133, "Audits of Institutions of Higher Education and Other Non-Profit Institutions," issued April 22, 1996. For effective dates, see paragraph 10.

4. Policy. Except as provided herein, the standards set forth in this Circular shall be applied by all Federal agencies. If any statute specifically prescribes policies or specific requirements that differ from the standards provided herein, the provisions of the subsequent statute shall govern.

Federal agencies shall apply the provisions of the sections of this Circular to non-Federal entities, whether they are recipients expending Federal awards received directly from Federal awarding agencies, or are subrecipients expending Federal awards received from a pass-through entity (a recipient or another subrecipient).

This Circular does not apply to non-U.S. based entities expending Federal awards received either directly as a recipient or indirectly as a subrecipient.

5. Definitions. The definitions of key terms used in this Circular are contained in §__105 in the Attachment to this Circular.

6. Required Action. The specific requirements and responsibilities of Federal agencies and non-Federal entities are set forth in the Attachment to this Circular. Federal agencies making awards to non-Federal entities, either directly or indirectly, shall adopt the language in the Circular in codified regulations as provided in Section 10 (below), unless different provisions are required by Federal statute or are approved by the Office of Management and Budget (OMB).

7. OMB Responsibilities. OMB will review Federal agency regulations and implementation of this Circular, and will provide interpretations of policy requirements and assistance to ensure uniform, effective and efficient implementation.

8. Information Contact. Further information concerning Circular A-133 may be obtained by contacting the Financial Standards and Reporting Branch, Office of Federal Financial Management, Office of Management and Budget, Washington, DC 20503, telephone (202) 395-3993.

9. Review Date. This Circular will have a policy review three years from the date of issuance.

10. Effective Dates. The standards set forth in §__400 of the Attachment to this Circular, which apply directly to Federal agencies, shall be effective July 1, 1996, and shall apply to audits of fiscal years beginning after June 30, 1996, except as otherwise specified in §__400(a).

The standards set forth in this Circular that Federal agencies shall apply to non-Federal entities shall be adopted by Federal agencies in codified regulations not later than 60 days after publication of this final revision in the **Federal Register**, so that they will apply to audits of fiscal years beginning after June 30, 1996, with the exception that §__305(b) of the Attachment applies to audits of fiscal years beginning after June 30, 1998. The requirements of Circular A-128, although the Circular is rescinded, and the 1990 version of Circular A-133 remain in effect for audits of fiscal years beginning on or before June 30, 1996.

The revisions published in the Federal Register June 27, 2003, are effective for fiscal years ending after December 31, 2003, and early implementation is

not permitted with the exception of the definition of oversight agency for audit which is effective July 28, 2003.

Augustine T. Smythe,
Acting Director

The revisions published in the Federal Register June 26, 2007, are effective for fiscal years ending on or after December 15, 2006.

Rob Portman
Director

Attachment

PART—AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS

Subpart A—General

Sec.

__100 Purpose.

__105 Definitions.

Subpart B—Audits

__200 Audit requirements.

__205 Basis for determining Federal awards expended.

__210 Subrecipient and vendor determinations.

__215 Relation to other audit requirements.

__220 Frequency of audits.

__225 Sanctions.

__230 Audit costs.

__235 Program-specific audits.

Subpart C—Auditees

__300 Auditee responsibilities.

__305 Auditor selection.

__310 Financial statements.

__315 Audit findings follow-up.

__320 Report submission.

Subpart D—Federal Agencies and Pass-Through Entities

__400 Responsibilities.

__405 Management decision.

Subpart E—Auditors

__500 Scope of audit.

__505 Audit reporting.

__510 Audit findings.

__515 Audit working papers.

- __520 Major program determination.
- __525 Criteria for Federal program risk.
- __530 Criteria for a low-risk auditee.

Appendix A to Part—Data Collection Form (Form SF-SAC).

Appendix B to Part—Circular A-133 Compliance Supplement.

Subpart A—General

§ __.100 Purpose.

This part sets forth standards for obtaining consistency and uniformity among Federal agencies for the audit of non-Federal entities expending Federal awards.

§ __.105 Definitions.

Auditee means any non-Federal entity that expends Federal awards which must be audited under this part.

Auditor means an auditor, that is a public accountant or a Federal, State or local government audit organization, which meets the general standards specified in generally accepted government auditing standards (GAGAS). The term auditor does not include internal auditors of non-profit organizations.

Audit finding means deficiencies which the auditor is required by § __.510(a) to report in the schedule of findings and questioned costs.

CFDA number means the number assigned to a Federal program in the Catalog of Federal Domestic Assistance (CFDA).

Cluster of programs means a grouping of closely related programs that share common compliance requirements. The types of clusters of programs are research and development (R&D), student financial aid (SFA), and other clusters. "Other clusters" are as defined by the Office of Management and Budget (OMB) in the compliance supplement or as designated by a State for Federal awards the State provides to its subrecipients that meet the definition of a cluster of programs. When designating an "other cluster," a State shall identify the Federal awards included in the cluster and advise the subrecipients of compliance requirements applicable to the cluster, consistent with § __.400(d)(1) and § __.400(d)(2), respectively. A cluster of programs shall be considered as one program for determining major programs, as described in § __.520, and, with the exception of R&D as described in § __.200(c), whether a program-specific audit may be elected.

Cognizant agency for audit means the Federal agency designated to carry out the responsibilities described in § __.400(a).

Compliance supplement refers to the Circular A-133 Compliance Supplement, included as Appendix B to Circular A-133, or such documents as OMB or its designee may issue to replace it. This document is available from the Government Printing Office, Superintendent of Documents, Washington, DC 20402-9325.

Corrective action means action taken by the auditee that:

- (1) Corrects identified deficiencies;
- (2) Produces recommended improvements; or
- (3) Demonstrates that audit findings are either invalid or do not warrant auditee action.

Federal agency has the same meaning as the term agency in Section 551(1) of title 5, United States Code.

Federal award means Federal financial assistance and Federal cost-reimbursement contracts that non-Federal entities receive directly from Federal awarding agencies or indirectly from pass-through entities. It does not include procurement contracts, under grants or contracts, used to buy goods or services from vendors. Any audits of such vendors shall be covered by the terms and conditions of the contract. Contracts to operate Federal Government owned, contractor operated facilities (GOCOs) are excluded from the requirements of this part.

Federal awarding agency means the Federal agency that provides an award directly to the recipient.

Federal financial assistance means assistance that non-Federal entities receive or administer in the form of grants, loans, loan guarantees, property (including donated surplus property), cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, and other assistance, but does not include amounts received as reimbursement for services rendered to individuals as described in §__205(h) and §__205(i).

Federal program means:

- (1) All Federal awards to a non-Federal entity assigned a single number in the CFDA.
- (2) When no CFDA number is assigned, all Federal awards from the same agency made for the same purpose should be combined and considered one program.
- (3) Notwithstanding paragraphs (1) and (2) of this definition, a cluster of programs. The types of clusters of programs are:
 - (i) Research and development (R&D);
 - (ii) Student financial aid (SFA); and
 - (iii) "Other clusters," as described in the definition of *cluster of programs* in this section.

GAGAS means generally accepted government auditing standards issued by the Comptroller General of the United States, which are applicable to financial audits.

Generally accepted accounting principles has the meaning specified in generally accepted auditing standards issued by the American Institute of Certified Public Accountants (AICPA).

Indian tribe means any Indian tribe, band, nation, or other organized group or community, including any Alaskan Native village or regional or village corporation (as defined in, or established under, the Alaskan Native Claims Settlement Act) that is recognized by the United States as eligible for the special programs and services provided by the United States to Indians because of their status as Indians.

Internal control means a process, effected by an entity's management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- (1) Effectiveness and efficiency of operations;
- (2) Reliability of financial reporting; and
- (3) Compliance with applicable laws and regulations.

Internal control pertaining to the compliance requirements for Federal programs (Internal control over Federal programs) means a process—effected by an entity's management and other personnel—designed to provide reasonable assurance regarding the achievement of the following objectives for Federal programs:

- (1) Transactions are properly recorded and accounted for to:
 - (i) Permit the preparation of reliable financial statements and Federal reports;
 - (ii) Maintain accountability over assets; and
 - (iii) Demonstrate compliance with laws, regulations, and other compliance requirements;
- (2) Transactions are executed in compliance with:
 - (i) Laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on a Federal program; and
 - (ii) Any other laws and regulations that are identified in the compliance supplement; and
- (3) Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition.

Loan means a Federal loan or loan guarantee received or administered by a non-Federal entity.

Local government means any unit of local government within a State, including a county, borough, municipality, city, town, township, parish, local public authority, special district, school district, intrastate district, council of governments, and any other instrumentality of local government.

Major program means a Federal program determined by the auditor to be a major program in accordance with §__520 or a program identified as a major program by a Federal agency or pass-through entity in accordance with §__215(c).

Management decision means the evaluation by the Federal awarding agency or pass-through entity of the audit findings and corrective action plan and the issuance of a written decision as to what corrective action is necessary.

Non-Federal entity means a State, local government, or non-profit organization.

Non-profit organization means:

- (1) any corporation, trust, association, cooperative, or other organization that:
 - (i) Is operated primarily for scientific, educational, service, charitable, or similar purposes in the public interest;
 - (ii) Is not organized primarily for profit; and
 - (iii) Uses its net proceeds to maintain, improve, or expand its operations; and
- (2) The term non-profit organization includes non-profit institutions of higher education and hospitals.

OMB means the Executive Office of the President, Office of Management and Budget.

Oversight agency for audit means the Federal awarding agency that provides the predominant amount of direct funding to a recipient not assigned a cognizant agency for audit. When there is no direct funding, the Federal agency

with the predominant indirect funding shall assume the oversight responsibilities. The duties of the oversight agency for audit are described in §__400(b).

Effective July 28, 2003, the following is added to this definition:

A Federal agency with oversight for an auditee may reassign oversight to another Federal agency which provides substantial funding and agrees to be the oversight agency for audit. Within 30 days after any reassignment, both the old and the new oversight agency for audit shall notify the auditee, and, if known, the auditor of the reassignment.

Pass-through entity means a non-Federal entity that provides a Federal award to a subrecipient to carry out a Federal program.

Program-specific audit means an audit of one Federal program as provided for in §__200(c) and §__235.

Questioned cost means a cost that is questioned by the auditor because of an audit finding:

- (1) Which resulted from a violation or possible violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of Federal funds, including funds used to match Federal funds;
- (2) Where the costs, at the time of the audit, are not supported by adequate documentation; or
- (3) Where the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.

Recipient means a non-Federal entity that expends Federal awards received directly from a Federal awarding agency to carry out a Federal program.

Research and development (R&D) means all research activities, both basic and applied, and all development activities that are performed by a non-Federal entity. Research is defined as a systematic study directed toward fuller scientific knowledge or understanding of the subject studied. The term research also includes activities involving the training of individuals in research techniques where such activities utilize the same facilities as other research and development activities and where such activities are not included in the instruction function. Development is the systematic use of knowledge and understanding gained from research directed toward the production of useful materials, devices, systems, or methods, including design and development of prototypes and processes.

Single audit means an audit which includes both the entity's financial statements and the Federal awards as described in §__500.

State means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, and the Trust Territory of the Pacific Islands, any instrumentality thereof, any multi-State, regional, or interstate entity which has governmental functions, and any Indian tribe as defined in this section.

Student Financial Aid (SFA) includes those programs of general student assistance, such as those authorized by Title IV of the Higher Education Act of 1965, as amended, (20 U.S.C. 1070 *et seq.*) which is administered by the U.S. Department of Education, and similar programs provided by other Federal agencies. It does not include programs which provide fellowships or similar Federal awards to students on a competitive basis, or for specified studies or research.

Subrecipient means a non-Federal entity that expends Federal awards received from a pass-through entity to carry out a Federal program, but does not include an individual that is a beneficiary of such a program. A subrecipient may also be a recipient of other Federal awards directly from a Federal awarding agency. Guidance on distinguishing between a subrecipient and a vendor is provided in § __.210.

Types of compliance requirements refers to the types of compliance requirements listed in the compliance supplement. Examples include: activities allowed or unallowed; allowable costs/cost principles; cash management; eligibility; matching; level of effort, earmarking; and, reporting.

Vendor means a dealer, distributor, merchant, or other seller providing goods or services that are required for the conduct of a Federal program. These goods or services may be for an organization's own use or for the use of beneficiaries of the Federal program. Additional guidance on distinguishing between a subrecipient and a vendor is provided in § __.210.

Subpart B—Audits

§ __.200 Audit requirements.

(a) *Audit required.* Non-Federal entities that expend \$300,000 (\$500,000 for fiscal years ending after December 31, 2003) or more in a year in Federal awards shall have a single or program-specific audit conducted for that year in accordance with the provisions of this part. Guidance on determining Federal awards expended is provided in § __.205.

(b) *Single audit.* Non-Federal entities that expend \$300,000 (\$500,000 for fiscal years ending after December 31, 2003) or more in a year in Federal awards shall have a single audit conducted in accordance with § __.500 except when they elect to have a program-specific audit conducted in accordance with paragraph (c) of this section.

(c) *Program-specific audit election.* When an auditee expends Federal awards under only one Federal program (excluding R&D) and the Federal program's laws, regulations, or grant agreements do not require a financial statement audit of the auditee, the auditee may elect to have a program-specific audit conducted in accordance with § __.235. A program-specific audit may not be elected for R&D unless all of the Federal awards expended were received from the same Federal agency, or the same Federal agency and the same pass-through entity, and that Federal agency, or pass-through entity in the case of a subrecipient, approves in advance a program-specific audit.

(d) *Exemption when Federal awards expended are less than \$300,000 (\$500,000 for fiscal years ending after December 31, 2003).* Non-Federal entities that expend less than \$300,000 (\$500,000 for fiscal years ending after December 31, 2003) a year in Federal awards are exempt from Federal audit requirements for that year, except as noted in § __.215(a), but records must be available for review or audit by appropriate officials of the Federal agency, pass-through entity, and General Accounting Office (GAO).

(e) *Federally Funded Research and Development Centers (FFRDC).* Management of an auditee that owns or operates a FFRDC may elect to treat the FFRDC as a separate entity for purposes of this part.

§ __.205 Basis for determining Federal awards expended.

(a) *Determining Federal awards expended.* The determination of when an award is expended should be based on when the activity related to the award occurs.

Generally, the activity pertains to events that require the non-Federal entity to comply with laws, regulations, and the provisions of contracts or grant agreements, such as: expenditure/expense transactions associated with grants, cost-reimbursement contracts, cooperative agreements, and direct appropriations; the disbursement of funds passed through to subrecipients; the use of loan proceeds under loan and loan guarantee programs; the receipt of property; the receipt of surplus property; the receipt or use of program income; the distribution or consumption of food commodities; the disbursement of amounts entitling the non-Federal entity to an interest subsidy; and, the period when insurance is in force.

(b) *Loan and loan guarantees (loans)*. Since the Federal Government is at risk for loans until the debt is repaid, the following guidelines shall be used to calculate the value of Federal awards expended under loan programs, except as noted in paragraphs (c) and (d) of this section:

- (1) Value of new loans made or received during the fiscal year; plus
- (2) Balance of loans from previous years for which the Federal Government imposes continuing compliance requirements; plus
- (3) Any interest subsidy, cash, or administrative cost allowance received.

(c) *Loan and loan guarantees (loans) at institutions of higher education*. When loans are made to students of an institution of higher education but the institution does not make the loans, then only the value of loans made during the year shall be considered Federal awards expended in that year. The balance of loans for previous years is not included as Federal awards expended because the lender accounts for the prior balances.

(d) *Prior loan and loan guarantees (loans)*. Loans, the proceeds of which were received and expended in prior-years, are not considered Federal awards expended under this part when the laws, regulations, and the provisions of contracts or grant agreements pertaining to such loans impose no continuing compliance requirements other than to repay the loans.

(e) *Endowment funds*. The cumulative balance of Federal awards for endowment funds which are federally restricted are considered awards expended in each year in which the funds are still restricted.

(f) *Free rent*. Free rent received by itself is not considered a Federal award expended under this part. However, free rent received as part of an award to carry out a Federal program shall be included in determining Federal awards expended and subject to audit under this part.

(g) *Valuing non-cash assistance*. Federal non-cash assistance, such as free rent, food stamps, food commodities, donated property, or donated surplus property, shall be valued at fair market value at the time of receipt or the assessed value provided by the Federal agency.

(h) *Medicare*. Medicare payments to a non-Federal entity for providing patient care services to Medicare eligible individuals are not considered Federal awards expended under this part.

(i) *Medicaid*. Medicaid payments to a subrecipient for providing patient care services to Medicaid eligible individuals are not considered Federal awards expended under this part unless a State requires the funds to be treated as Federal awards expended because reimbursement is on a cost-reimbursement basis.

(j) *Certain loans provided by the National Credit Union Administration.* For purposes of this part, loans made from the National Credit Union Share Insurance Fund and the Central Liquidity Facility that are funded by contributions from insured institutions are not considered Federal awards expended.

§__210 Subrecipient and vendor determinations.

(a) *General.* An auditee may be a recipient, a subrecipient, and a vendor. Federal awards expended as a recipient or a subrecipient would be subject to audit under this part. The payments received for goods or services provided as a vendor would not be considered Federal awards. The guidance in paragraphs (b) and (c) of this section should be considered in determining whether payments constitute a Federal award or a payment for goods and services.

(b) *Federal award.* Characteristics indicative of a Federal award received by a subrecipient are when the organization:

- (1) Determines who is eligible to receive what Federal financial assistance;
- (2) Has its performance measured against whether the objectives of the Federal program are met;
- (3) Has responsibility for programmatic decision making;
- (4) Has responsibility for adherence to applicable Federal program compliance requirements; and
- (5) Uses the Federal funds to carry out a program of the organization as compared to providing goods or services for a program of the pass-through entity.

(c) *Payment for goods and services.* Characteristics indicative of a payment for goods and services received by a vendor are when the organization:

- (1) Provides the goods and services within normal business operations;
- (2) Provides similar goods or services to many different purchasers;
- (3) Operates in a competitive environment;
- (4) Provides goods or services that are ancillary to the operation of the Federal program; and
- (5) Is not subject to compliance requirements of the Federal program.

(d) *Use of judgment in making determination.* There may be unusual circumstances or exceptions to the listed characteristics. In making the determination of whether a subrecipient or vendor relationship exists, the substance of the relationship is more important than the form of the agreement. It is not expected that all of the characteristics will be present and judgment should be used in determining whether an entity is a subrecipient or vendor.

(e) *For-profit subrecipient.* Since this part does not apply to for-profit subrecipients, the pass-through entity is responsible for establishing requirements, as necessary, to ensure compliance by for-profit subrecipients. The contract with the for-profit subrecipient should describe applicable compliance requirements and the for-profit subrecipient's compliance responsibility. Methods to ensure compliance for Federal awards made to for-profit subrecipients may include pre-award audits, monitoring during the contract, and post-award audits.

(f) *Compliance responsibility for vendors.* In most cases, the auditee's compliance responsibility for vendors is only to ensure that the procurement, receipt, and payment for goods and services comply with laws, regulations, and the provisions of contracts or grant agreements. Program compliance requirements

normally do not pass through to vendors. However, the auditee is responsible for ensuring compliance for vendor transactions which are structured such that the vendor is responsible for program compliance or the vendor's records must be reviewed to determine program compliance. Also, when these vendor transactions relate to a major program, the scope of the audit shall include determining whether these transactions are in compliance with laws, regulations, and the provisions of contracts or grant agreements.

§ __.215 Relation to other audit requirements.

(a) *Audit under this part in lieu of other audits.* An audit made in accordance with this part shall be in lieu of any financial audit required under individual Federal awards. To the extent this audit meets a Federal agency's needs, it shall rely upon and use such audits. The provisions of this part neither limit the authority of Federal agencies, including their Inspectors General, or GAO to conduct or arrange for additional audits (e.g., financial audits, performance audits, evaluations, inspections, or reviews) nor authorize any auditee to constrain Federal agencies from carrying out additional audits. Any additional audits shall be planned and performed in such a way as to build upon work performed by other auditors.

(b) *Federal agency to pay for additional audits.* A Federal agency that conducts or contracts for additional audits shall, consistent with other applicable laws and regulations, arrange for funding the full cost of such additional audits.

(c) *Request for a program to be audited as a major program.* A Federal agency may request an auditee to have a particular Federal program audited as a major program in lieu of the Federal agency conducting or arranging for the additional audits. To allow for planning, such requests should be made at least 180 days prior to the end of the fiscal year to be audited. The auditee, after consultation with its auditor, should promptly respond to such request by informing the Federal agency whether the program would otherwise be audited as a major program using the risk-based audit approach described in § __.520 and, if not, the estimated incremental cost. The Federal agency shall then promptly confirm to the auditee whether it wants the program audited as a major program. If the program is to be audited as a major program based upon this Federal agency request, and the Federal agency agrees to pay the full incremental costs, then the auditee shall have the program audited as a major program. A pass-through entity may use the provisions of this paragraph for a subrecipient.

§ __.220 Frequency of audits.

Except for the provisions for biennial audits provided in paragraphs (a) and (b) of this section, audits required by this part shall be performed annually. Any biennial audit shall cover both years within the biennial period.

(a) A State or local government that is required by constitution or statute, in effect on January 1, 1987, to undergo its audits less frequently than annually, is permitted to undergo its audits pursuant to this part biennially. This requirement must still be in effect for the biennial period

(b) Any non-profit organization that had biennial audits for all biennial periods ending between July 1, 1992, and January 1, 1995, is permitted to undergo its audits pursuant to this part biennially.

§ __.225 Sanctions.

No audit costs may be charged to Federal awards when audits required by this part have not been made or have been made but not in accordance with this part. In cases of continued inability or unwillingness to have an audit conducted

in accordance with this part, Federal agencies and pass-through entities shall take appropriate action using sanctions such as:

- (a) Withholding a percentage of Federal awards until the audit is completed satisfactorily;
- (b) Withholding or disallowing overhead costs;
- (c) Suspending Federal awards until the audit is conducted; or
- (d) Terminating the Federal award.

§ __.230 Audit costs.

(a) *Allowable costs.* Unless prohibited by law, the cost of audits made in accordance with the provisions of this part are allowable charges to Federal awards. The charges may be considered a direct cost or an allocated indirect cost, as determined in accordance with the provisions of applicable OMB cost principles circulars, the Federal Acquisition Regulation (FAR) (48 CFR parts 30 and 31), or other applicable cost principles or regulations.

(b) *Unallowable costs.* A non-Federal entity shall not charge the following to a Federal award:

- (1) The cost of any audit under the Single Audit Act Amendments of 1996 (31 U.S.C. 7501 et seq.) not conducted in accordance with this part.
- (2) The cost of auditing a non-Federal entity which has Federal awards expended of less than \$300,000 (\$500,000 for fiscal years ending after December 31, 2003) per year and is thereby exempted under § __.200(d) from having an audit conducted under this part. However, this does not prohibit a pass-through entity from charging Federal awards for the cost of limited scope audits to monitor its subrecipients in accordance with § __.400(d)(3), provided the subrecipient does not have a single audit. For purposes of this part, limited scope audits only include agreed-upon procedures engagements conducted in accordance with either the AICPA's generally accepted auditing standards or attestation standards, that are paid for and arranged by a pass-through entity and address only one or more of the following types of compliance requirements: activities allowed or unallowed; allowable costs/cost principles; eligibility; matching, level of effort, earmarking; and, reporting.

§ __.235 Program-specific audits.

(a) *Program-specific audit guide available.* In many cases, a program-specific audit guide will be available to provide specific guidance to the auditor with respect to internal control, compliance requirements, suggested audit procedures, and audit reporting requirements. The auditor should contact the Office of Inspector General of the Federal agency to determine whether such a guide is available. When a current program-specific audit guide is available, the auditor shall follow GAGAS and the guide when performing a program-specific audit.

(b) *Program-specific audit guide not available.* (1) When a program-specific audit guide is not available, the auditee and auditor shall have basically the same responsibilities for the Federal program as they would have for an audit of a major program in a single audit.

- (2) The auditee shall prepare the financial statement(s) for the Federal program that includes, at a minimum, a schedule of expenditures of Federal awards for the program and notes that describe the significant accounting policies used in preparing the schedule, a summary schedule of prior audit findings consistent with the requirements of § __,315(b), and a corrective action plan consistent with the requirements of § __,315(c).
- (3) The auditor shall:
 - (i) Perform an audit of the financial statement(s) for the Federal program in accordance with GAGAS;
 - (ii) Obtain an understanding of internal control and perform tests of internal control over the Federal program consistent with the requirements of § __,500(c) for a major program;
 - (iii) Perform procedures to determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on the Federal program consistent with the requirements of § __,500(d) for a major program; and
 - (iv) Follow up on prior audit findings, perform procedures to assess the reasonableness of the summary schedule of prior audit findings prepared by the auditee, and report, as a current year audit finding, when the auditor concludes that the summary schedule of prior audit findings materially misrepresents the status of any prior audit finding in accordance with the requirements of § __,500(e).
- (4) The auditor's report(s) may be in the form of either combined or separate reports and may be organized differently from the manner presented in this section. The auditor's report(s) shall state that the audit was conducted in accordance with this part and include the following:
 - (i) An opinion (or disclaimer of opinion) as to whether the financial statement(s) of the Federal program is presented fairly in all material respects in conformity with the stated accounting policies;
 - (ii) A report on internal control related to the Federal program, which shall describe the scope of testing of internal control and the results of the tests;
 - (iii) A report on compliance which includes an opinion (or disclaimer of opinion) as to whether the auditee complied with laws, regulations, and the provisions of contracts or grant agreements which could have a direct and material effect on the Federal program; and
 - (iv) A schedule of findings and questioned costs for the Federal program that includes a summary of the auditor's results relative to the Federal program in a format consistent with § __,505(d)(1) and findings and questioned costs consistent with the requirements of § __,505(d)(3).

(c) Report submission for program-specific audits.

- (1) The audit shall be completed and the reporting required by paragraph (c)(2) or (c)(3) of this section submitted within the earlier of 30 days after receipt of the auditor's report(s), or nine months after the end of the audit period, unless a longer period is agreed to in advance by the Federal agency that provided the funding or a different period is specified in a program-specific audit guide. (However, for fiscal years beginning on or before June 30, 1998, the audit shall be completed and the required reporting shall be submitted within the earlier of 30 days after receipt of the auditor's report(s), or 13 months after the end of the audit period, unless a different period is specified in a program-specific audit guide.) Unless restricted by law or regulation, the auditee shall make report copies available for public inspection.
- (2) When a program-specific audit guide is available, the auditee shall submit to the Federal clearinghouse designated by OMB the data collection form prepared in accordance with § __.320(b), as applicable to a program-specific audit, and the reporting required by the program-specific audit guide to be retained as an archival copy. Also, the auditee shall submit to the Federal awarding agency or pass-through entity the reporting required by the program-specific audit guide.
- (3) When a program-specific audit guide is not available, the reporting package for a program-specific audit shall consist of the financial statement(s) of the Federal program, a summary schedule of prior audit findings, and a corrective action plan as described in paragraph (b)(2) of this section, and the auditor's report(s) described in paragraph (b)(4) of this section. The data collection form prepared in accordance with § __.320(b), as applicable to a program-specific audit, and one copy of this reporting package shall be submitted to the Federal clearinghouse designated by OMB to be retained as an archival copy. Also, when the schedule of findings and questioned costs disclosed audit findings or the summary schedule of prior audit findings reported the status of any audit findings, the auditee shall submit one copy of the reporting package to the Federal clearinghouse on behalf of the Federal awarding agency, or directly to the pass-through entity in the case of a subrecipient. Instead of submitting the reporting package to the pass-through entity, when a subrecipient is not required to submit a reporting package to the pass-through entity, the subrecipient shall provide written notification to the pass-through entity, consistent with the requirements of § __.320(e)(2). A subrecipient may submit a copy of the reporting package to the pass-through entity to comply with this notification requirement.

(d) Other sections of this part may apply. Program-specific audits are subject to § __.100 through § __.215(b), § __.220 through § __.230, § __.300 through § __.305, § __.315, § __.320(f) through § __.320(j), § __.400 through § __.405, § __.510 through § __.515, and other referenced provisions of this part unless contrary to the provisions of this section, a program-specific audit guide, or program laws and regulations.

Subpart C—Auditees

§ __.300 Auditee responsibilities.

The auditee shall:

- (a) Identify, in its accounts, all Federal awards received and expended and the Federal programs under which they were received. Federal program and award identification shall include, as applicable, the CFDA title and number, award number and year, name of the Federal agency, and name of the pass-through entity.
- (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.
- (c) Comply with laws, regulations, and the provisions of contracts or grant agreements related to each of its Federal programs.
- (d) Prepare appropriate financial statements, including the schedule of expenditures of Federal awards in accordance with § __.310.
- (e) Ensure that the audits required by this part are properly performed and submitted when due. When extensions to the report submission due date required by § __.320(a) are granted by the cognizant or oversight agency for audit, promptly notify the Federal clearinghouse designated by OMB and each pass-through entity providing Federal awards of the extension.
- (f) Follow up and take corrective action on audit findings, including preparation of a summary schedule of prior audit findings and a corrective action plan in accordance with § __.315(b) and § __.315(c), respectively.

§ __.305 Auditor selection.

(a) *Auditor procurement.* In procuring audit services, auditees shall follow the procurement standards prescribed by the Grants Management Common Rule (hereinafter referred to as the "A-102 Common Rule") published March 11, 1988 and amended April 19, 1995 [insert appropriate CFR citation], Circular A-110, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Non-Profit Organizations," or the FAR (48 CFR part 42), as applicable (OMB Circulars are available from the Office of Administration, Publications Office, room 2200, New Executive Office Building, Washington, DC 20503). Whenever possible, auditees shall make positive efforts to utilize small businesses, minority-owned firms, and women's business enterprises, in procuring audit services as stated in the A-102 Common Rule, OMB Circular A-110, or the FAR (48 CFR part 42), as applicable. In requesting proposals for audit services, the objectives and scope of the audit should be made clear. Factors to be considered in evaluating each proposal for audit services include the responsiveness to the request for proposal, relevant experience, availability of staff with professional qualifications and technical abilities, the results of external quality control reviews, and price.

(b) *Restriction on auditor preparing indirect cost proposals.* An auditor who prepares the indirect cost proposal or cost allocation plan may not also be selected to perform the audit required by this part when the indirect costs recovered by

the auditee during the prior year exceeded \$1 million. This restriction applies to the base year used in the preparation of the indirect cost proposal or cost allocation plan and any subsequent years in which the resulting indirect cost agreement or cost allocation plan is used to recover costs. To minimize any disruption in existing contracts for audit services, this paragraph applies to audits of fiscal years beginning after June 30, 1998.

(c) *Use of Federal auditors.* Federal auditors may perform all or part of the work required under this part if they comply fully with the requirements of this part.

§__310 Financial statements.

(a) *Financial statements.* The auditee shall prepare financial statements that reflect its financial position, results of operations or changes in net assets, and, where appropriate, cash flows for the fiscal year audited. The financial statements shall be for the same organizational unit and fiscal year that is chosen to meet the requirements of this part. However, organization-wide financial statements may also include departments, agencies, and other organizational units that have separate audits in accordance with §__500(a) and prepare separate financial statements.

(b) *Schedule of expenditures of Federal awards.* The auditee shall also prepare a schedule of expenditures of Federal awards for the period covered by the auditee's financial statements. While not required, the auditee may choose to provide information requested by Federal awarding agencies and pass-through entities to make the schedule easier to use. For example, when a Federal program has multiple award years, the auditee may list the amount of Federal awards expended for each award year separately. At a minimum, the schedule shall:

- (1) List individual Federal programs by Federal agency. For Federal programs included in a cluster of programs, list individual Federal programs within a cluster of programs. For R&D, total Federal awards expended shall be shown either by individual award or by Federal agency and major subdivision within the Federal agency. For example, the National Institutes of Health is a major subdivision in the Department of Health and Human Services.
- (2) For Federal awards received as a subrecipient, the name of the pass-through entity and identifying number assigned by the pass-through entity shall be included.
- (3) Provide total Federal awards expended for each individual Federal program and the CFDA number or other identifying number when the CFDA information is not available.
- (4) Include notes that describe the significant accounting policies used in preparing the schedule.
- (5) To the extent practical, pass-through entities should identify in the schedule the total amount provided to subrecipients from each Federal program.
- (6) Include, in either the schedule or a note to the schedule, the value of the Federal awards expended in the form of non-cash assistance, the amount of insurance in effect during the year, and loans or loan guarantees outstanding at year end. While not required, it is preferable to present this information in the schedule.

§ __.315 Audit findings follow-up.

(a) *General.* The auditee is responsible for follow-up and corrective action on all audit findings. As part of this responsibility, the auditee shall prepare a summary schedule of prior audit findings. The auditee shall also prepare a corrective action plan for current year audit findings. The summary schedule of prior audit findings and the corrective action plan shall include the reference numbers the auditor assigns to audit findings under § __.510(c). Since the summary schedule may include audit findings from multiple years, it shall include the fiscal year in which the finding initially occurred.

(b) *Summary schedule of prior audit findings.* The summary schedule of prior audit findings shall report the status of all audit findings included in the prior audit's schedule of findings and questioned costs relative to Federal awards. The summary schedule shall also include audit findings reported in the prior audit's summary schedule of prior audit findings except audit findings listed as corrected in accordance with paragraph (b)(1) of this section, or no longer valid or not warranting further action in accordance with paragraph (b)(4) of this section.

- (1) When audit findings were fully corrected, the summary schedule need only list the audit findings and state that corrective action was taken.
- (2) When audit findings were not corrected or were only partially corrected, the summary schedule shall describe the planned corrective action as well as any partial corrective action taken.
- (3) When corrective action taken is significantly different from corrective action previously reported in a corrective action plan or in the Federal agency's or pass-through entity's management decision, the summary schedule shall provide an explanation.
- (4) When the auditee believes the audit findings are no longer valid or do not warrant further action, the reasons for this position shall be described in the summary schedule. A valid reason for considering an audit finding as not warranting further action is that all of the following have occurred:
 - (i) Two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse;
 - (ii) The Federal agency or pass-through entity is not currently following up with the auditee on the audit finding; and
 - (iii) A management decision was not issued.

(c) *Corrective action plan.* At the completion of the audit, the auditee shall prepare a corrective action plan to address each audit finding included in the current year auditor's reports. The corrective action plan shall provide the name(s) of the contact person(s) responsible for corrective action, the corrective action planned, and the anticipated completion date. If the auditee does not agree with the audit findings or believes corrective action is not required, then the corrective action plan shall include an explanation and specific reasons.

§ __.320 Report submission.

(a) *General.* The audit shall be completed and the data collection form described in paragraph (b) of this section and reporting package described in paragraph (c) of this section shall be submitted within the earlier of 30 days after receipt of the auditor's report(s), or nine months after the end of the audit period, unless

a longer period is agreed to in advance by the cognizant or oversight agency for audit. (However, for fiscal years beginning on or before June 30, 1998, the audit shall be completed and the data collection form and reporting package shall be submitted within the earlier of 30 days after receipt of the auditor's report(s), or 13 months after the end of the audit period.) Unless restricted by law or regulation, the auditee shall make copies available for public inspection.

(b) *Data Collection.* (1) The auditee shall submit a data collection form which states whether the audit was completed in accordance with this part and provides information about the auditee, its Federal programs, and the results of the audit. The form shall be approved by OMB, available from the Federal clearinghouse designated by OMB, and include data elements similar to those presented in this paragraph. A senior level representative of the auditee (e.g., State controller, director of finance, chief executive officer, or chief financial officer) shall sign a statement to be included as part of the form certifying that: the auditee complied with the requirements of this part, the form was prepared in accordance with this part (and the instructions accompanying the form), and the information included in the form, in its entirety, are accurate and complete.

(2) The data collection form shall include the following data elements:

- (i) The type of report the auditor issued on the financial statements of the auditee (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion).
- (ii) Where applicable, a statement that significant deficiencies in internal control were disclosed by the audit of the financial statements and whether any such conditions were material weaknesses.
- (iii) A statement as to whether the audit disclosed any non-compliance which is material to the financial statements of the auditee.
- (iv) Where applicable, a statement that significant deficiencies in internal control over major programs were disclosed by the audit and whether any such conditions were material weaknesses.
- (v) The type of report the auditor issues on compliance for major programs (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion).
- (vi) A list of the Federal awarding agencies which will receive a copy of the reporting package pursuant to §__320(d)(2) of OMB Circular A-133.
- (vii) A yes or no statement as to whether the auditee qualified as a low-risk auditee under §__530 of OMB Circular A-133.
- (viii) The dollar threshold used to distinguish between Type A and Type B programs as defined in §__520(b) of OMB Circular A-133.
- (ix) The *Catalog of Federal Domestic Assistance* (CFDA) number for each Federal program, as applicable.
- (x) The name of each Federal program and identification of each major program. Individual programs within a cluster of program should be listed in the same level of detail as

they are listed in the schedule of expenditures of Federal awards.

- (xi) The amount of expenditures in the schedule of expenditures of Federal awards associated with each Federal program.
 - (xii) For each Federal program, a yes or no statement as to whether there are audit findings in each of the following types of compliance requirements and the total amount of any questioned costs:
 - (A) Activities allowed or unallowed.
 - (B) Allowable costs/cost principles.
 - (C) Cash management.
 - (D) Davis-Bacon Act.
 - (E) Eligibility.
 - (F) Equipment and real property management.
 - (G) Matching, level of effort, earmarking.
 - (H) Period of availability of Federal funds.
 - (I) Procurement and suspension and debarment.
 - (J) Program income.
 - (K) Real property acquisition and relocation assistance.
 - (L) Reporting.
 - (M) Subrecipient monitoring.
 - (N) Special tests and provisions.
 - (xiii) Auditee Name, Employer Identification Number(s), Name and Title of Certifying Official, Telephone Number, Signature, and Date.
 - (xiv) Auditor Name, Name and Title of Contact Person, Auditor Address, Auditor Telephone Number, Signature, and Date.
 - (xv) Whether the auditee has either a cognizant or oversight agency for audit.
 - (xvi) The name of the cognizant or oversight agency for audit determined in accordance with § __.400(a) and § __.400(b), respectively.
- (3) Using the information included in the reporting package described in paragraph (c) of this section, the auditor shall complete the applicable sections of the form. The auditor shall sign a statement to be included as part of the data collection form that indicates, at a minimum, the source of the information included in the form, the auditor's responsibility for the information, that the form is not a substitute for the reporting package described in paragraph (c) of this section, and that the content of the form is limited to the data elements prescribed by OMB.

(c) *Reporting package.* The reporting package shall include the:

- (1) Financial statements and schedule of expenditures of Federal awards discussed in § __.310(a) and § __.310(b), respectively;

- (2) Summary schedule of prior audit findings discussed in § __.315(b);
- (3) Auditor's report(s) discussed in § __.505; and
- (4) Corrective action plan discussed in § __.315(c).

(d) *Submission to clearinghouse.* All auditees shall submit to the Federal clearinghouse designated by OMB a single copy of the data collection form described in paragraph (b) of this section and the reporting package described in paragraph (c) of this section.

(e) *Additional submission by subrecipients.* (1) In addition to the requirements discussed in paragraph (d) of this section, auditees that are also subrecipients shall submit to each pass-through entity one copy of the reporting package described in paragraph (c) of this section for each pass-through entity when the schedule of findings and questioned costs disclosed audit findings relating to Federal awards that the pass-through entity provided or the summary schedule of prior audit findings reported the status of any audit findings relating to Federal awards that the pass-through entity provided.

- (2) Instead of submitting the reporting package to a pass-through entity, when a subrecipient is not required to submit a reporting package to a pass-through entity pursuant to paragraph (e)(1) of this section, the subrecipient shall provide written notification to the pass-through entity that: an audit of the subrecipient was conducted in accordance with this part (including the period covered by the audit and the name, amount, and CFDA number of the Federal award(s) provided by the pass-through entity); the schedule of findings and questioned costs disclosed no audit findings relating to the Federal award(s) that the pass-through entity provided; and, the summary schedule of prior audit findings did not report on the status of any audit findings relating to the Federal award(s) that the pass-through entity provided. A subrecipient may submit a copy of the reporting package described in paragraph (c) of this section to a pass-through entity to comply with this notification requirement.

(f) *Requests for report copies.* In response to requests by a Federal agency or pass-through entity, auditees shall submit the appropriate copies of the reporting package described in paragraph (c) of this section and, if requested, a copy of any management letters issued by the auditor.

(g) *Report retention requirements.* Auditees shall keep one copy of the data collection form described in paragraph (b) of this section and one copy of the reporting package described in paragraph (c) of this section on file for three years from the date of submission to the Federal clearinghouse designated by OMB. Pass-through entities shall keep subrecipients' submissions on file for three years from date of receipt.

(h) *Clearinghouse responsibilities.* The Federal clearinghouse designated by OMB shall distribute the reporting packages received in accordance with paragraph (d)(2) of this section and § __.235(c)(3) to applicable Federal awarding agencies, maintain a data base of completed audits, provide appropriate information to Federal agencies, and follow up with known auditees which have not submitted the required data collection forms and reporting packages.

(i) *Clearinghouse address.* The address of the Federal clearinghouse currently designated by OMB is Federal Audit Clearinghouse, Bureau of the Census, 1201 E. 10th Street, Jeffersonville, IN 47132.

(j) *Electronic filing.* Nothing in this part shall preclude electronic submissions to the Federal clearinghouse in such manner as may be approved by OMB. With OMB approval, the Federal clearinghouse may pilot test methods of electronic submissions.

Subpart D—Federal Agencies and Pass-Through Entities

§ __.400 Responsibilities.

(a) *Cognizant agency for audit responsibilities.* Recipients expending more than \$25 million (\$50 million for fiscal years ending after December 31, 2003) a year in Federal awards shall have a cognizant agency for audit. The designated cognizant agency for audit shall be the Federal awarding agency that provides the predominant amount of direct funding to a recipient unless OMB makes a specific cognizant agency for audit assignment.

Following is effective for fiscal years ending on or before December 31, 2003:

To provide for continuity of cognizance, the determination of the predominant amount of direct funding shall be based upon direct Federal awards expended in the recipient's fiscal years ending in 1995, 2000, 2005, and every fifth year thereafter. For example, audit cognizance for periods ending in 1997 through 2000 will be determined based on Federal awards expended in 1995. (However, for States and local governments that expend more than \$25 million a year in Federal awards and have previously assigned cognizant agencies for audit, the requirements of this paragraph are not effective until fiscal years beginning after June 30, 2000.)

Following is effective for fiscal years ending after December 31, 2003:

The determination of the predominant amount of direct funding shall be based upon direct Federal awards expended in the recipient's fiscal years ending in 2004, 2009, 2014, and every fifth year thereafter. For example, audit cognizance for periods ending in 2006 through 2010 will be determined based on Federal awards expended in 2004. (However, for 2001 through 2005, the cognizant agency for audit is determined based on the predominant amount of direct Federal awards expended in the recipient's fiscal year ending in 2000).

Notwithstanding the manner in which audit cognizance is determined, a Federal awarding agency with cognizance for an auditee may reassign cognizance to another Federal awarding agency which provides substantial direct funding and agrees to be the cognizant agency for audit. Within 30 days after any reassignment, both the old and the new cognizant agency for audit shall notify the auditee, and, if known, the auditor of the reassignment. The cognizant agency for audit shall:

- (1) Provide technical audit advice and liaison to auditees and auditors.
- (2) Consider auditee requests for extensions to the report submission due date required by § __.320(a). The cognizant agency for audit may grant extensions for good cause.
- (3) Obtain or conduct quality control reviews of selected audits made by non-Federal auditors, and provide the results, when appropriate, to other interested organizations.
- (4) Promptly inform other affected Federal agencies and appropriate Federal law enforcement officials of any direct reporting by the auditee or its auditor of irregularities or illegal acts, as required by GAGAS or laws and regulations.

- (5) Advise the auditor and, where appropriate, the auditee of any deficiencies found in the audits when the deficiencies require corrective action by the auditor. When advised of deficiencies, the auditee shall work with the auditor to take corrective action. If corrective action is not taken, the cognizant agency for audit shall notify the auditor, the auditee, and applicable Federal awarding agencies and pass-through entities of the facts and make recommendations for follow-up action. Major inadequacies or repetitive substandard performance by auditors shall be referred to appropriate State licensing agencies and professional bodies for disciplinary action.
- (6) Coordinate, to the extent practical, audits or reviews made by or for Federal agencies that are in addition to the audits made pursuant to this part, so that the additional audits or reviews build upon audits performed in accordance with this part.
- (7) Coordinate a management decision for audit findings that affect the Federal programs of more than one agency.
- (8) Coordinate the audit work and reporting responsibilities among auditors to achieve the most cost-effective audit.
- (9) For biennial audits permitted under § __.220, consider auditee requests to qualify as a low-risk auditee under § __.530(a).

(b) *Oversight agency for audit responsibilities.* An auditee which does not have a designated cognizant agency for audit will be under the general oversight of the Federal agency determined in accordance with § __.105. The oversight agency for audit:

- (1) Shall provide technical advice to auditees and auditors as requested.
- (2) May assume all or some of the responsibilities normally performed by a cognizant agency for audit.

(c) *Federal awarding agency responsibilities.* The Federal awarding agency shall perform the following for the Federal awards it makes:

- (1) Identify Federal awards made by informing each recipient of the CFDA title and number, award name and number, award year, and if the award is for R&D. When some of this information is not available, the Federal agency shall provide information necessary to clearly describe the Federal award.
- (2) Advise recipients of requirements imposed on them by Federal laws, regulations, and the provisions of contracts or grant agreements.
- (3) Ensure that audits are completed and reports are received in a timely manner and in accordance with the requirements of this part.
- (4) Provide technical advice and counsel to auditees and auditors as requested.
- (5) Issue a management decision on audit findings within six months after receipt of the audit report and ensure that the recipient takes appropriate and timely corrective action.
- (6) Assign a person responsible for providing annual updates of the compliance supplement to OMB.

(d) *Pass-through entity responsibilities.* A pass-through entity shall perform the following for the Federal awards it makes:

- (1) Identify Federal awards made by informing each subrecipient of CFDA title and number, award name and number, award year, if the award is R&D, and name of Federal agency. When some of this information is not available, the pass-through entity shall provide the best information available to describe the Federal award.
- (2) Advise subrecipients of requirements imposed on them by Federal laws, regulations, and the provisions of contracts or grant agreements as well as any supplemental requirements imposed by the pass-through entity.
- (3) Monitor the activities of subrecipients as necessary to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.
- (4) Ensure that subrecipients expending \$300,000 (\$500,000 for fiscal years ending after December 31, 2003) or more in Federal awards during the subrecipient's fiscal year have met the audit requirements of this part for that fiscal year.
- (5) Issue a management decision on audit findings within six months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action.
- (6) Consider whether subrecipient audits necessitate adjustment of the pass-through entity's own records.
- (7) Require each subrecipient to permit the pass-through entity and auditors to have access to the records and financial statements as necessary for the pass-through entity to comply with this part.

§ __.405 Management decision.

(a) *General.* The management decision shall clearly state whether or not the audit finding is sustained, the reasons for the decision, and the expected auditee action to repay disallowed costs, make financial adjustments, or take other action. If the auditee has not completed corrective action, a timetable for follow-up should be given. Prior to issuing the management decision, the Federal agency or pass-through entity may request additional information or documentation from the auditee, including a request for auditor assurance related to the documentation, as a way of mitigating disallowed costs. The management decision should describe any appeal process available to the auditee.

(b) *Federal agency.* As provided in § __.400(a)(7), the cognizant agency for audit shall be responsible for coordinating a management decision for audit findings that affect the programs of more than one Federal agency. As provided in § __.400(c)(5), a Federal awarding agency is responsible for issuing a management decision for findings that relate to Federal awards it makes to recipients. Alternate arrangements may be made on a case-by-case basis by agreement among the Federal agencies concerned.

(c) *Pass-through entity.* As provided in § __.400(d)(5), the pass-through entity shall be responsible for making the management decision for audit findings that relate to Federal awards it makes to subrecipients.

(d) *Time requirements.* The entity responsible for making the management decision shall do so within six months of receipt of the audit report. Corrective

action should be initiated within six months after receipt of the audit report and proceed as rapidly as possible.

(e) *Reference numbers.* Management decisions shall include the reference numbers the auditor assigned to each audit finding in accordance with § __.510(c).

Subpart E—Auditors

§ __.500 Scope of audit.

(a) *General.* The audit shall be conducted in accordance with GAGAS. The audit shall cover the entire operations of the auditee; or, at the option of the auditee, such audit shall include a series of audits that cover departments, agencies, and other organizational units which expended or otherwise administered Federal awards during such fiscal year, provided that each such audit shall encompass the financial statements and schedule of expenditures of Federal awards for each such department, agency, and other organizational unit, which shall be considered to be a non-Federal entity. The financial statements and schedule of expenditures of Federal awards shall be for the same fiscal year.

(b) *Financial statements.* The auditor shall determine whether the financial statements of the auditee are presented fairly in all material respects in conformity with generally accepted accounting principles. The auditor shall also determine whether the schedule of expenditures of Federal awards is presented fairly in all material respects in relation to the auditee's financial statements taken as a whole.

(c) *Internal control.* (1) In addition to the requirements of GAGAS, the auditor shall perform procedures to obtain an understanding of internal control over Federal programs sufficient to plan the audit to support a low assessed level of control risk for major programs.

(2) Except as provided in paragraph (c)(3) of this section, the auditor shall:

- (i) Plan the testing of internal control over major programs to support a low assessed level of control risk for the assertions relevant to the compliance requirements for each major program; and
- (ii) Perform testing of internal control as planned in paragraph (c)(2)(i) of this section.

(3) When internal control over some or all of the compliance requirements for a major program are likely to be ineffective in preventing or detecting noncompliance, the planning and performing of testing described in paragraph (c)(2) of this section are not required for those compliance requirements. However, the auditor shall report a significant deficiency (including whether any such condition is a material weakness) in accordance with § __.510, assess the related control risk at the maximum, and consider whether additional compliance tests are required because of ineffective internal control.

(d) *Compliance.* (1) In addition to the requirements of GAGAS, the auditor shall determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that may have a direct and material effect on each of its major programs.

(2) The principal compliance requirements applicable to most Federal programs and the compliance requirements of the largest Federal programs are included in the compliance supplement.

- (3) For the compliance requirements related to Federal programs contained in the compliance supplement, an audit of these compliance requirements will meet the requirements of this part. Where there have been changes to the compliance requirements and the changes are not reflected in the compliance supplement, the auditor shall determine the current compliance requirements and modify the audit procedures accordingly. For those Federal programs not covered in the compliance supplement, the auditor should use the types of compliance requirements contained in the compliance supplement as guidance for identifying the types of compliance requirements to test, and determine the requirements governing the Federal program by reviewing the provisions of contracts and grant agreements and the laws and regulations referred to in such contracts and grant agreements.
- (4) The compliance testing shall include tests of transactions and such other auditing procedures necessary to provide the auditor sufficient evidence to support an opinion on compliance.

(e) *Audit follow-up.* The auditor shall follow-up on prior audit findings, perform procedures to assess the reasonableness of the summary schedule of prior audit findings prepared by the auditee in accordance with § __.315(b), and report, as a current year audit finding, when the auditor concludes that the summary schedule of prior audit findings materially misrepresents the status of any prior audit finding. The auditor shall perform audit follow-up procedures regardless of whether a prior audit finding relates to a major program in the current year.

(f) *Data Collection Form.* As required in § __.320(b)(3), the auditor shall complete and sign specified sections of the data collection form.

§ __.505 Audit reporting.

The auditor's report(s) may be in the form of either combined or separate reports and may be organized differently from the manner presented in this section. The auditor's report(s) shall state that the audit was conducted in accordance with this part and include the following:

- (a) An opinion (or disclaimer of opinion) as to whether the financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles and an opinion (or disclaimer of opinion) as to whether the schedule of expenditures of Federal awards is presented fairly in all material respects in relation to the financial statements taken as a whole.
- (b) A report on internal control related to the financial statements and major programs. This report shall describe the scope of testing of internal control and the results of the tests, and, where applicable, refer to the separate schedule of findings and questioned costs described in paragraph (d) of this section.
- (c) A report on compliance with laws, regulations, and the provisions of contracts or grant agreements, noncompliance with which could have a material effect on the financial statements. This report shall also include an opinion (or disclaimer of opinion) as to whether the auditee complied with laws, regulations, and the provisions of contracts or grant agreements which could have a direct and material effect on each major program, and, where applicable, refer to the separate schedule of findings and questioned costs described in paragraph (d) of this section.

(d) A schedule of findings and questioned costs which shall include the following three components:

- (1) A summary of the auditor's results which shall include:
 - (i) The type of report the auditor issued on the financial statements of the auditee (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion);
 - (ii) Where applicable, a statement that significant deficiencies in internal control were disclosed by the audit of the financial statements and whether any such conditions were material weaknesses;
 - (iii) A statement as to whether the audit disclosed any non-compliance which is material to the financial statements of the auditee;
 - (iv) Where applicable, a statement that significant deficiencies in internal control over major programs were disclosed by the audit and whether any such conditions were material weaknesses;
 - (v) The type of report the auditor issued on compliance for major programs (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion);
 - (vi) A statement as to whether the audit disclosed any audit findings which the auditor is required to report under § __.510(a);
 - (vii) An identification of major programs;
 - (viii) The dollar threshold used to distinguish between Type A and Type B programs, as described in § __.520(b); and
 - (ix) A statement as to whether the auditee qualified as a low-risk auditee under § __.530.
- (2) Findings relating to the financial statements which are required to be reported in accordance with GAGAS.
- (3) Findings and questioned costs for Federal awards which shall include audit findings as defined in § __.510(a).
 - (i) Audit findings (e.g., internal control findings, compliance findings, questioned costs, or fraud) which relate to the same issue should be presented as a single audit finding. Where practical, audit findings should be organized by Federal agency or pass-through entity.
 - (ii) Audit findings which relate to both the financial statements and Federal awards, as reported under paragraphs (d)(2) and (d)(3) of this section, respectively, should be reported in both sections of the schedule. However, the reporting in one section of the schedule may be in summary form with a reference to a detailed reporting in the other section of the schedule.

§ __.510 Audit findings.

(a) *Audit findings reported.* The auditor shall report the following as audit findings in a schedule of findings and questioned costs:

- (1) Significant deficiencies in internal control over major programs. The auditor's determination of whether a deficiency in internal control is a significant deficiency for the purpose of reporting an audit finding is in relation to a type of compliance requirement for a major program or an audit objective identified in the compliance supplement. The auditor shall identify significant deficiencies which are individually or cumulatively material weaknesses.
- (2) Material noncompliance with the provisions of laws, regulations, contracts, or grant agreements related to a major program. The auditor's determination of whether a noncompliance with the provisions of laws, regulations, contracts, or grant agreements is material for the purpose of reporting an audit finding is in relation to a type of compliance requirement for a major program or an audit objective identified in the compliance supplement.
- (3) Known questioned costs which are greater than \$10,000 for a type of compliance requirement for a major program. Known questioned costs are those specifically identified by the auditor. In evaluating the effect of questioned costs on the opinion on compliance, the auditor considers the best estimate of total costs questioned (likely questioned costs), not just the questioned costs specifically identified (known questioned costs). The auditor shall also report known questioned costs when likely questioned costs are greater than \$10,000 for a type of compliance requirement for a major program. In reporting questioned costs, the auditor shall include information to provide proper perspective for judging the prevalence and consequences of the questioned costs.
- (4) Known questioned costs which are greater than \$10,000 for a Federal program which is not audited as a major program. Except for audit follow-up, the auditor is not required under this part to perform audit procedures for such a Federal program; therefore, the auditor will normally not find questioned costs for a program which is not audited as a major program. However, if the auditor does become aware of questioned costs for a Federal program which is not audited as a major program (e.g., as part of audit follow-up or other audit procedures) and the known questioned costs are greater than \$10,000, then the auditor shall report this as an audit finding.
- (5) The circumstances concerning why the auditor's report on compliance for major programs is other than an unqualified opinion, unless such circumstances are otherwise reported as audit findings in the schedule of findings and questioned costs for Federal awards.
- (6) Known fraud affecting a Federal award, unless such fraud is otherwise reported as an audit finding in the schedule of findings and questioned costs for Federal awards. This paragraph does not require the auditor to make an additional reporting when the auditor confirms that the fraud was reported outside of the auditor's reports under the direct reporting requirements of GAGAS.
- (7) Instances where the results of audit follow-up procedures disclosed that the summary schedule of prior audit findings prepared by the

auditee in accordance with §__315(b) materially misrepresents the status of any prior audit finding.

(b) *Audit finding detail.* Audit findings shall be presented in sufficient detail for the auditee to prepare a corrective action plan and take corrective action and for Federal agencies and pass-through entities to arrive at a management decision. The following specific information shall be included, as applicable, in audit findings:

- (1) Federal program and specific Federal award identification including the CFDA title and number, Federal award number and year, name of Federal agency, and name of the applicable pass-through entity. When information, such as the CFDA title and number or Federal award number, is not available, the auditor shall provide the best information available to describe the Federal award.
- (2) The criteria or specific requirement upon which the audit finding is based, including statutory, regulatory, or other citation.
- (3) The condition found, including facts that support the deficiency identified in the audit finding.
- (4) Identification of questioned costs and how they were computed.
- (5) Information to provide proper perspective for judging the prevalence and consequences of the audit findings, such as whether the audit findings represent an isolated instance or a systemic problem. Where appropriate, instances identified shall be related to the universe and the number of cases examined and be quantified in terms of dollar value.
- (6) The possible asserted effect to provide sufficient information to the auditee and Federal agency, or pass-through entity in the case of a subrecipient, to permit them to determine the cause and effect to facilitate prompt and proper corrective action.
- (7) Recommendations to prevent future occurrences of the deficiency identified in the audit finding.
- (8) Views of responsible officials of the auditee when there is disagreement with the audit findings, to the extent practical.

(c) *Reference numbers.* Each audit finding in the schedule of findings and questioned costs shall include a reference number to allow for easy referencing of the audit findings during follow-up.

§__515 Audit working papers.

(a) *Retention of working papers.* The auditor shall retain working papers and reports for a minimum of three years after the date of issuance of the auditor's report(s) to the auditee, unless the auditor is notified in writing by the cognizant agency for audit, oversight agency for audit, or pass-through entity to extend the retention period. When the auditor is aware that the Federal awarding agency, pass-through entity, or auditee is contesting an audit finding, the auditor shall contact the parties contesting the audit finding for guidance prior to destruction of the working papers and reports.

(b) *Access to working papers.* Audit working papers shall be made available upon request to the cognizant or oversight agency for audit or its designee, a Federal agency providing direct or indirect funding, or GAO at the completion of the audit, as part of a quality review, to resolve audit findings, or to carry out oversight responsibilities consistent with the purposes of this part. Access

to working papers includes the right of Federal agencies to obtain copies of working papers, as is reasonable and necessary.

§ __.520 Major program determination.

(a) *General.* The auditor shall use a risk-based approach to determine which Federal programs are major programs. This risk-based approach shall include consideration of: Current and prior audit experience, oversight by Federal agencies and pass-through entities, and the inherent risk of the Federal program. The process in paragraphs (b) through (i) of this section shall be followed.

(b) *Step 1.* (1) The auditor shall identify the larger Federal programs, which shall be labeled Type A programs. Type A programs are defined as Federal programs with Federal awards expended during the audit period exceeding the larger of:

- (i) \$300,000 or three percent (.03) of total Federal awards expended in the case of an auditee for which total Federal awards expended equal or exceed \$300,000 but are less than or equal to \$100 million.
 - (ii) \$3 million or three-tenths of one percent (.003) of total Federal awards expended in the case of an auditee for which total Federal awards expended exceed \$100 million but are less than or equal to \$10 billion.
 - (iii) \$30 million or 15 hundredths of one percent (.0015) of total Federal awards expended in the case of an auditee for which total Federal awards expended exceed \$10 billion.
- (2) Federal programs not labeled Type A under paragraph (b)(1) of this section shall be labeled Type B programs.
- (3) The inclusion of large loan and loan guarantees (loans) should not result in the exclusion of other programs as Type A programs. When a Federal program providing loans significantly affects the number or size of Type A programs, the auditor shall consider this Federal program as a Type A program and exclude its values in determining other Type A programs.
- (4) For biennial audits permitted under § __.220, the determination of Type A and Type B programs shall be based upon the Federal awards expended during the two-year period.

(c) *Step 2.* (1) The auditor shall identify Type A programs which are low-risk. For a Type A program to be considered low-risk, it shall have been audited as a major program in at least one of the two most recent audit periods (in the most recent audit period in the case of a biennial audit), and, in the most recent audit period, it shall have had no audit findings under § __.510(a). However, the auditor may use judgment and consider that audit findings from questioned costs under § __.510(a)(3) and § __.510(a)(4), fraud under § __.510(a)(6), and audit follow-up for the summary schedule of prior audit findings under § __.510(a)(7) do not preclude the Type A program from being low-risk. The auditor shall consider: the criteria in § __.525(c), § __.525(d)(1), § __.525(d)(2), and § __.525(d)(3); the results of audit follow-up; whether any changes in personnel or systems affecting a Type A program have significantly increased risk;

and apply professional judgment in determining whether a Type A program is low-risk.

- (2) Notwithstanding paragraph (c)(1) of this section, OMB may approve a Federal awarding agency's request that a Type A program at certain recipients may not be considered low-risk. For example, it may be necessary for a large Type A program to be audited as major each year at particular recipients to allow the Federal agency to comply with the Government Management Reform Act of 1994 (31 U.S.C. 3515). The Federal agency shall notify the recipient and, if known, the auditor at least 180 days prior to the end of the fiscal year to be audited of OMB's approval.

(d) *Step 3.* (1) The auditor shall identify Type B programs which are high-risk using professional judgment and the criteria in §__525. However, should the auditor select Option 2 under Step 4 (paragraph (e)(2)(i)(B) of this section), the auditor is not required to identify more high-risk Type B programs than the number of low-risk Type A programs. Except for known significant deficiencies in internal control or compliance problems as discussed in §__525(b)(1), §__525(b)(2), and §__525(c)(1), a single criteria in §__525 would seldom cause a Type B program to be considered high-risk.

- (2) The auditor is not expected to perform risk assessments on relatively small Federal programs. Therefore, the auditor is only required to perform risk assessments on Type B programs that exceed the larger of:
 - (i) \$100,000 or three-tenths of one percent (.003) of total Federal awards expended when the auditee has less than or equal to \$100 million in total Federal awards expended.
 - (ii) \$300,000 or three-hundredths of one percent (.0003) of total Federal awards expended when the auditee has more than \$100 million in total Federal awards expended.

(e) *Step 4.* At a minimum, the auditor shall audit all of the following as major programs:

- (1) All Type A programs, except the auditor may exclude any Type A programs identified as low-risk under Step 2 (paragraph (c)(1) of this section).
- (2) (i) High-risk Type B programs as identified under either of the following two options:
 - (A) Option 1. At least one half of the Type B programs identified as high-risk under Step 3 (paragraph (d) of this section), except this paragraph (e)(2)(i)(A) does not require the auditor to audit more high-risk Type B programs than the number of low-risk Type A programs identified as low-risk under Step 2.
 - (B) Option 2. One high-risk Type B program for each Type A program identified as low-risk under Step 2.
- (ii) When identifying which high-risk Type B programs to audit as major under either Option 1 or 2 in paragraph (e)(2)(i)(A) or (B), the auditor is encouraged to use an approach which provides an opportunity for different

high-risk Type B programs to be audited as major over a period of time.

- (3) Such additional programs as may be necessary to comply with the percentage of coverage rule discussed in paragraph (f) of this section. This paragraph (e)(3) may require the auditor to audit more programs as major than the number of Type A programs.

(f) *Percentage of coverage rule.* The auditor shall audit as major programs Federal programs with Federal awards expended that, in the aggregate, encompass at least 50 percent of total Federal awards expended. If the auditee meets the criteria in § __.530 for a low-risk auditee, the auditor need only audit as major programs Federal programs with Federal awards expended that, in the aggregate, encompass at least 25 percent of total Federal awards expended.

(g) *Documentation of risk.* The auditor shall document in the working papers the risk analysis process used in determining major programs.

(h) *Auditor's judgment.* When the major program determination was performed and documented in accordance with this part, the auditor's judgment in applying the risk-based approach to determine major programs shall be presumed correct. Challenges by Federal agencies and pass-through entities shall only be for clearly improper use of the guidance in this part. However, Federal agencies and pass-through entities may provide auditors guidance about the risk of a particular Federal program and the auditor shall consider this guidance in determining major programs in audits not yet completed.

(i) *Deviation from use of risk criteria.* For first-year audits, the auditor may elect to determine major programs as all Type A programs plus any Type B programs as necessary to meet the percentage of coverage rule discussed in paragraph (f) of this section. Under this option, the auditor would not be required to perform the procedures discussed in paragraphs (c), (d), and (e) of this section.

- (1) A first-year audit is the first year the entity is audited under this part or the first year of a change of auditors.
- (2) To ensure that a frequent change of auditors would not preclude audit of high-risk Type B programs, this election for first-year audits may not be used by an auditee more than once in every three years.

§ __.525 Criteria for Federal program risk.

(a) *General.* The auditor's determination should be based on an overall evaluation of the risk of noncompliance occurring which could be material to the Federal program. The auditor shall use auditor judgment and consider criteria, such as described in paragraphs (b), (c), and (d) of this section, to identify risk in Federal programs. Also, as part of the risk analysis, the auditor may wish to discuss a particular Federal program with auditee management and the Federal agency or pass-through entity.

(b) *Current and prior audit experience.* (1) Weaknesses in internal control over Federal programs would indicate higher risk. Consideration should be given to the control environment over Federal programs and such factors as the expectation of management's adherence to applicable laws and regulations and the provisions of contracts and grant agreements and the competence and experience of personnel who administer the Federal programs.

- (i) A Federal program administered under multiple internal control structures may have higher risk. When assessing risk in a large single audit, the auditor shall consider

whether weaknesses are isolated in a single operating unit (e.g., one college campus) or pervasive throughout the entity.

- (ii) When significant parts of a Federal program are passed through to subrecipients, a weak system for monitoring subrecipients would indicate higher risk.
- (iii) The extent to which computer processing is used to administer Federal programs, as well as the complexity of that processing, should be considered by the auditor in assessing risk. New and recently modified computer systems may also indicate risk.
- (2) Prior audit findings would indicate higher risk, particularly when the situations identified in the audit findings could have a significant impact on a Federal program or have not been corrected.
- (3) Federal programs not recently audited as major programs may be of higher risk than Federal programs recently audited as major programs without audit findings.

(c) *Oversight exercised by Federal agencies and pass-through entities.* (1) Oversight exercised by Federal agencies or pass-through entities could indicate risk. For example, recent monitoring or other reviews performed by an oversight entity which disclosed no significant problems would indicate lower risk. However, monitoring which disclosed significant problems would indicate higher risk.

- (2) Federal agencies, with the concurrence of OMB, may identify Federal programs which are higher risk. OMB plans to provide this identification in the compliance supplement.

(d) *Inherent risk of the Federal program.* (1) The nature of a Federal program may indicate risk. Consideration should be given to the complexity of the program and the extent to which the Federal program contracts for goods and services. For example, Federal programs that disburse funds through third party contracts or have eligibility criteria may be of higher risk. Federal programs primarily involving staff payroll costs may have a high-risk for time and effort reporting, but otherwise be at low-risk.

- (2) The phase of a Federal program in its life cycle at the Federal agency may indicate risk. For example, a new Federal program with new or interim regulations may have higher risk than an established program with time-tested regulations. Also, significant changes in Federal programs, laws, regulations, or the provisions of contracts or grant agreements may increase risk.
- (3) The phase of a Federal program in its life cycle at the auditee may indicate risk. For example, during the first and last years that an auditee participates in a Federal program, the risk may be higher due to start-up or closeout of program activities and staff.
- (4) Type B programs with larger Federal awards expended would be of higher risk than programs with substantially smaller Federal awards expended.

§__530 Criteria for a low-risk auditee.

An auditee which meets all of the following conditions for each of the preceding two years (or, in the case of biennial audits, preceding two audit periods) shall qualify as a low-risk auditee and be eligible for reduced audit coverage in accordance with §__520:

- (a) Single audits were performed on an annual basis in accordance with the provisions of this part. A non-Federal entity that has biennial audits does not qualify as a low-risk auditee, unless agreed to in advance by the cognizant or oversight agency for audit.
- (b) The auditor's opinions on the financial statements and the schedule of expenditures of Federal awards were unqualified. However, the cognizant or oversight agency for audit may judge that an opinion qualification does not affect the management of Federal awards and provide a waiver.
- (c) There were no deficiencies in internal control which were identified as material weaknesses under the requirements of GAGAS. However, the cognizant or oversight agency for audit may judge that any identified material weaknesses do not affect the management of Federal awards and provide a waiver.
- (d) None of the Federal programs had audit findings from any of the following in either of the preceding two years (or, in the case of biennial audits, preceding two audit periods) in which they were classified as Type A programs:
 - (1) Internal control deficiencies which were identified as material weaknesses;
 - (2) Noncompliance with the provisions of laws, regulations, contracts, or grant agreements which have a material effect on the Type A program; or
 - (3) Known or likely questioned costs that exceed five percent of the total Federal awards expended for a Type A program during the year.

Appendix A to Part—Data Collection Form (Form SF-SAC)

[insert SF-SAC after finalized]

Appendix B to Part—Circular A-133 Compliance Supplement

Note: Provisional OMB Circular A-133 Compliance Supplement is available from the Office of Administration, Publications Office, room 2200, New Executive Office Building, Washington, DC 20503.

Appendix C

Schedule of Changes Made to the Text From the Previous Edition

As of May 1, 2010

This schedule of changes identifies areas in the text and footnotes of this guide that have changed since the previous edition. Entries in the table of this appendix reflect current numbering, lettering (including that in appendix names), and character designations that resulted from the renumbering or reordering that occurred in the updating of this guide.

| <u>Reference</u> | <u>Change</u> |
|----------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| General | Use of the term <i>not-for-profit organization</i> was replaced by <i>not-for-profit entity</i> , and the acronym NPO was replaced by NFP, except in certain cases in which a specific publication (such as the Office of Management and Budget [OMB] Circular A-133, <i>Audits of States, Local Governments, and Non-Profit Organizations</i> [Circular A-133]) is being cited or discussed. |
| Notice to Readers | Deleted. |
| Preface | Updated. |
| Footnote 5 in paragraph 1.01 | Revised to reflect OMB's issuance of revised Circular A-133. |
| Footnote 6 in paragraph 1.01 | Revised for the passage of time. |
| Paragraph 1.05 | Revised for clarification. |
| Paragraph 1.12 | Revised to reflect the issuance of Statement on Auditing Standards (SAS) No. 117, <i>Compliance Audits</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 801); former footnote * deleted. |
| Paragraphs 1.13–.14 | Revised to reflect the issuance of SAS No. 117. |
| Footnote 5 in paragraph 2.07 | Revised for clarification. |
| Footnote 16 to heading before paragraph 2.22 | Revised for clarification. |
| Former footnote * in paragraph 2.22 | Deleted. |
| Paragraphs 2.23 and 2.41 | Revised for clarification. |

(continued)

| <u>Reference</u> | <u>Change</u> |
|-------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Footnote 1 in paragraph 3.01 | Added to reflect the issuance of SAS No. 117. |
| Paragraph 3.08 | Revised to reflect the guidance in SAS No. 115, <i>Communicating Internal Control Related Matters Identified in an Audit</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 325). |
| Paragraph 3.10 | Revised to reflect the guidance in SAS No. 115; former footnote * deleted. |
| Former paragraph 3.14 | Deleted due to the issuance of SAS No. 117; former footnote † deleted. |
| Paragraph 3.18 | Revised for clarification; footnote * added. |
| Paragraph 3.26 | Revised for passage of time. |
| Paragraph 3.31 | Revised for clarification. |
| Footnotes *, †, and ‡ in paragraph 4.03 | Revised. |
| Footnote ll to heading before paragraph 4.04 | Added. |
| Footnote 9 in paragraph 4.05 and paragraph 4.06 | Revised to reflect the issuance of SAS No. 115; footnote * to table in paragraph 4.06 added. |
| Paragraph 4.07 | Revised to reflect the issuance of SAS No. 115; former footnote ll deleted. |
| Paragraph 4.09 | Revised to reflect the issuance of SAS No. 115; footnote 12 revised. |
| Footnote 19 in paragraph 4.22, paragraph 4.26 | Revised for clarification. |
| Paragraph 4.28 | Revised to reflect revisions made to incorporate the guidance in SAS No. 115 to the reports required under <i>Government Auditing Standards</i> . |
| Footnote # to heading before paragraph 4.29 | Added. |
| Paragraph 4.35 | Revised for clarification. |
| Footnote 41 in paragraph 4.46 | Revised to reflect the issuance of SAS No. 115. |
| Former paragraph 4.51 | Deleted due to issuance of SAS No. 115. |
| Footnote * in paragraph 4.51 | Revised. |
| Footnote 3 in paragraph 4.51 | Revised for clarification. |

| <u>Reference</u> | <u>Change</u> |
|-----------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------|
| Note to chapter 5 | Revised. |
| Former footnote * to heading before paragraph 5.01 | Deleted. |
| Paragraph 5.03 | Revised to reflect the issuance of SAS No. 117; footnote 6 added to reflect the issuance of SAS No. 117. |
| Paragraph 5.04 | Revised for clarification; former footnote † deleted. |
| Footnotes * and † in paragraph 5.05 | Revised. |
| Paragraph 5.06 | Revised to reflect the issuance of SAS No. 117, footnote ‡ added. |
| Footnote 9 in paragraph 5.06 | Added to reflect the issuance of SAS No. 117. |
| Table 5-1 | Revised to reflect the issuance of SAS No. 117. |
| Paragraph 5.18 | Revised for clarification. |
| Paragraphs 5.29–.30 and .48 | Revised to reflect the issuance of SAS No. 117. |
| Heading before paragraph 5.49, paragraphs 5.49–.51, and footnote | Added to reflect information related to the American Recovery and Reinvestment Act of 2009 (Recovery Act). |
| Former footnote * to chapter 6 title | Deleted. |
| Note to chapter 6 | Revised. |
| Paragraph 6.02 | Revised to reflect the issuance of SAS No. 117, revised for clarification. |
| Heading before paragraph 6.03 | Revised to reflect the issuance of SAS No. 117. |
| Former paragraph 6.03 | Deleted to reflect the issuance of SAS No. 117; former footnote † deleted. |
| Paragraphs 6.03–.07, heading before paragraph 6.07, and footnotes 1–2 | Added to reflect the issuance of SAS No. 117. |
| Paragraph 6.08 | Revised to reflect the issuance of SAS No. 117; revised for clarification. |
| Paragraph 6.10 | Added to reflect the issuance of SAS No. 117. |

(continued)

| <u>Reference</u> | <u>Change</u> |
|----------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------|
| Heading before paragraph 6.11 and paragraphs 6.21 and 6.23 | Revised for clarification. |
| Heading and footnote 9 before paragraph 6.24 and paragraphs 6.24–.25 | Added to reflect the issuance of SAS No. 117. |
| Heading and paragraph 6.26 | Revised to reflect the issuance of SAS No. 117. |
| Footnote 10 in paragraph 6.27 and heading and paragraph 6.29 | Revised to reflect the issuance of SAS No. 117; former footnote ‡ deleted. |
| Paragraphs 6.30–.32 and footnotes 11–12 | Added to reflect the issuance of SAS No. 117. |
| Former paragraph 6.33 | Deleted to reflect the issuance of SAS No. 117. |
| Paragraphs 6.33–.36 | Revised to reflect the issuance of SAS No. 117. |
| Paragraphs 6.37–.38, footnote 13, and paragraphs 6.40–.41 | Added to reflect the issuance of SAS No. 117. |
| Former paragraphs 6.40–.41 | Deleted for clarification. |
| Paragraphs 6.43–.44 | Revised to reflect the issuance of SAS No. 117; footnote 15 in paragraph 6.44 added for clarification. |
| Former paragraph 6.45 | Deleted to reflect issuance of SAS No. 117. |
| Paragraphs 6.45–.48 | Added for clarification. |
| Paragraphs 6.49 and 6.51 | Added to reflect the issuance of SAS No. 117. |
| Paragraphs 6.53–.54 | Revised for clarification. |
| Paragraph 6.55 | Revised to reflect the issuance of SAS No. 117; footnote 18 added for clarification. |
| Paragraph 6.58 | Revised for clarification. |
| Paragraphs 6.59–.64 | Added for clarification. |
| Heading and paragraph 6.66 | Revised for clarification. |
| Former footnote # in paragraph 6.67 | Deleted. |

| <u>Reference</u> | <u>Change</u> |
|----------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Heading and footnote * before paragraph 6.70 and paragraphs 6.70–.74 | Added to reflect information related to the Recovery Act |
| Note to chapter 7 | Revised. |
| Former footnote * to chapter 7 title | Deleted. |
| Footnote * in paragraph 7.01 | Revised. |
| Paragraph 7.08 | Revised to reflect the issuance of SAS No. 115; former footnote ‡ deleted. |
| Paragraph 7.21 | Revised to reflect the guidance in AU section 311, <i>Planning and Supervision</i> (AICPA, <i>Professional Standards</i> , vol. 1). |
| Heading before paragraph 7.22 | Added to reflect information related to the Recovery Act; footnote † added. |
| Paragraphs 7.22–.24 and footnote ‡ | Added to reflect information related to the Recovery Act. |
| Footnote * to heading before paragraph 7.25 | Added. |
| Footnote * to heading before paragraph 7.26 | Revised. |
| Paragraph 7.26 | Revised to reflect the guidance in AU section 311. |
| Footnote 2 in paragraph 7.26 | Revised to reflect the issuance of SAS No. 119, <i>Supplementary Information in Relation to the Financial Statements as a Whole</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 551). |
| Note to chapter 8 | Revised. |
| Former footnote * to chapter title | Deleted. |
| Footnote 1 to heading before paragraph 8.01 | Added to reflect the issuance of SAS No. 117. |
| Paragraph 8.02 | Revised to reflect the issuance of SAS No. 117. |
| Paragraph 8.07 | Revised to reflect current OMB guidance. |
| Paragraph 8.08 | Added to reflect current OMB guidance; footnote * added. |
| Paragraph 8.09 | Revised to reflect current OMB guidance. |

(continued)

| <u>Reference</u> | <u>Change</u> |
|----------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Former footnote † to heading before paragraph 8.11 | Deleted. |
| Paragraphs 8.13 and 8.15 | Revised to reflect the issuance of SAS No. 117. |
| Footnote 2 in paragraph 8.26 | Added to reflect current OMB guidance. |
| Heading before paragraph 8.37 and paragraph 8.37 | Revised to reflect the issuance of SAS No. 117. |
| Heading and footnote † before paragraph 8.38 and paragraphs 8.38–.39 | Added to reflect information related to the Recovery Act. |
| Paragraphs 8.40–.43 | Added to reflect information related to the Recovery Act. |
| Note to chapter 9 | Revised. |
| Former footnote * to heading before paragraph 9.01 | Deleted. |
| Paragraph 9.03 | Revised for clarification; former footnote † deleted; footnote 1 added to reflect the issuance of SAS No. 117; and footnote 2 revised to reflect the issuance of SAS No. 117. |
| Paragraphs 9.06–.07 | Revised for clarification. |
| Paragraphs 9.08–.11 | Revised to reflect the issuance of SAS No. 117. |
| Paragraph 9.15 | Revised for clarification. |
| Paragraph 9.17 | Revised to reflect the issuance of SAS No. 117. |
| Heading before paragraph 9.20 | Revised to reflect the issuance of SAS No. 117; footnote 4 added. |
| Paragraphs 9.20–.24 and heading before paragraph 9.22 | Revised to reflect the issuance of SAS No. 117. |
| Paragraph 9.25 | Revised for clarification. |
| Paragraph 9.26 | Revised to reflect the issuance of SAS No. 117, footnote 5 added for clarification. |
| Paragraph 9.27 | Revised to reflect the issuance of SAS No. 117. |
| Paragraph 9.28 | Revised to reflect the issuance of SAS No. 117; revised for clarification. |
| Former footnote 3 to heading before paragraph 9.29 | Deleted due to information being added to text to reflect the issuance of SAS No. 117. |

| <u>Reference</u> | <u>Change</u> |
|-----------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Paragraph 9.30 | Revised to reflect the issuance of SAS No. 117. |
| Paragraph 9.31 | Added to reflect the issuance of SAS No. 117. |
| Paragraphs 9.33–.34 and 9.36 | Revised to reflect the issuance of SAS No. 117. |
| Paragraphs 9.38 and 9.40 | Added to reflect the issuance of SAS No. 117. |
| Heading before paragraph 9.40 | Revised to reflect the issuance of SAS No. 117; former footnote # deleted. |
| Paragraph 9.40 | Added to reflect the issuance of SAS No. 117. |
| Paragraph 9.41 | Revised to reflect the issuance of SAS No. 117; footnote 8 added for clarification; former footnotes 5 and 6 deleted to reflect the issuance of SAS No. 117. |
| Paragraphs 9.43–.44 | Revised to reflect the issuance of SAS No. 115 and SAS No. 117. |
| Paragraph 9.45 | Revised to reflect the issuance of SAS No. 115; former footnote ** deleted. |
| Former paragraph 9.46 | Deleted to reflect the issuance of SAS No. 115. |
| Paragraph 9.46 | Revised to reflect the issuance of SAS No. 115 and SAS No. 117. |
| Former paragraph 9.47 | Deleted to reflect the issuance of SAS No. 115. |
| Paragraph 9.47 | Revised for clarification. |
| Paragraph 9.48 | Revised to reflect the issuance of SAS No. 115 and SAS No. 117. |
| Paragraph 9.49 | Revised to reflect the issuance of SAS No. 117; revised for clarification. |
| Paragraphs 9.50–.51 | Added to reflect the issuance of SAS No. 115. |
| Paragraph 9.52 | Revised to reflect the issuance of SAS No. 117. |
| Paragraph 9.53 | Revised to reflect the issuance of SAS No. 117; footnote 9 added for clarification. |
| Paragraph 9.54 | Revised for clarification. |
| Heading and paragraph 9.58 | Added to reflect information related to the Recovery Act; footnotes *, †, and ‡ added. |
| Note to chapter 10 | Revised. |
| Former footnote * to heading before paragraph 10.01 | Deleted. |
| Paragraph 10.02 | Added to reflect the issuance of SAS No. 117; footnote 1 added. |

(continued)

| <u>Reference</u> | <u>Change</u> |
|----------------------------------------------------------------|----------------------------------------------------------------------------------------------------------|
| Paragraphs 10.03–.04 and 10.06 and heading and paragraph 10.07 | Revised to reflect the issuance of SAS No. 117. |
| Paragraphs 10.08–.09 | Added to reflect the issuance of SAS No. 117. |
| Paragraphs 10.10–.11 | Revised to reflect the issuance of SAS No. 117. |
| Former footnote † in the heading before 10.14 | Deleted. |
| Paragraph 10.15 | Revised to reflect the issuance of SAS No. 117; revised for clarification. |
| Paragraph 10.17 | Revised for clarification. |
| Former footnote ‡ in heading before paragraph 10.18 | Deleted. |
| Paragraphs 10.18–.19 | Revised for clarification. |
| Former footnote to heading before paragraph 10.20 | Deleted. |
| Paragraphs 10.21 and 10.26–.28 | Revised for clarification. |
| Paragraph 10.29 | Revised to reflect the issuance of SAS No. 117. |
| Paragraph 10.31 | Revised for clarification. |
| Paragraph 10.32 | Revised to reflect the issuance of SAS No. 117; footnote 4 added to reflect the issuance of SAS No. 117. |
| Former footnote * to heading before paragraph 10.33 | Deleted. |
| Paragraph 10.33 | Revised to reflect the issuance of SAS No. 117. |
| Paragraph 10.35 | Revised to reflect the issuance of SAS No. 117; revised for clarification. |
| Paragraphs 10.36 and 10.38–.39 | Revised to reflect the issuance of SAS No. 117. |
| Paragraph 10.40 | Revised to reflect the issuance of SAS No. 117; revised for clarification. |
| Paragraph 10.43 | Revised to reflect the guidance in AU section 311. |
| Paragraphs 10.46–.48 and 10.50 | Revised to reflect the issuance of SAS No. 117. |

| <u>Reference</u> | <u>Change</u> |
|--------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------|
| Paragraph 10.51 | Added to reflect the issuance of SAS No. 117. |
| Paragraphs 10.52–.53 | Revised to reflect the issuance of SAS No. 117. |
| Paragraph 10.57 | Revised for clarification. |
| Paragraph 10.61 | Revised to reflect the issuance of SAS No. 117. |
| Heading and paragraph 10.70 | Added to reflect the issuance of SAS No. 117. |
| Paragraph 10.72 | Revised to reflect the issuance of SAS No. 117. |
| Former footnotes 11–12 in paragraph 10.72 | Deleted to reflect issuance of SAS No. 117. |
| Footnote 17 in paragraph 10.72 | Added to reflect the issuance of SAS No. 117. |
| Heading and paragraph 10.75 | Added to reflect information related to the Recovery Act; footnote * added. |
| Note to chapter 11 | Revised. |
| Paragraph 11.01, footnote 2 in paragraph 11.08, and paragraphs 11.11, 11.15, and 11.22 | Revised to reflect the issuance of SAS No. 117. |
| Footnote 5 in paragraph 11.26 | Added to reflect the issuance of SAS No. 117. |
| Paragraphs 11.50 and 11.53–.54 | Revised to reflect the issuance of SAS No. 115 and SAS No. 117. |
| Paragraph 11.59 | Revised to reflect the issuance of SAS No. 117; footnote 10 added for clarification. |
| Paragraph 11.61 | Revised for clarification. |
| Paragraph 11.64, heading and paragraph 11.65, paragraph 11.67, footnote 12 in paragraph 11.69, and paragraph 11.71 | Revised to reflect the issuance of SAS No. 117. |
| Paragraph 11.79 | Revised to reflect the issuance of SAS No. 117; revised for clarification. |
| Paragraphs 11.80–.81 | Revised to reflect the issuance of SAS No. 117. |
| Paragraph 11.86 | Revised for clarification. |

(continued)

| <u>Reference</u> | <u>Change</u> |
|-----------------------------------------------------|----------------------------------------------------------------------------------------------------------|
| Paragraph 11.100 | Revised to reflect the issuance of SAS No. 117; footnote 17 added for clarification. |
| Paragraph 11.101 | Revised to reflect the issuance of SAS No. 115 and SAS No. 117. |
| Paragraphs 11.108 and 11.111 | Revised to reflect the issuance of SAS No. 117. |
| Paragraph 11.112 | Revised to reflect the issuance of SAS No. 115 and SAS No. 117. |
| Heading and paragraph 11.113 | Revised to reflect the issuance of SAS No. 115 and SAS No. 117; footnote 20 revised. |
| Paragraphs 11.114–.115 | Revised to reflect the issuance of SAS No. 117. |
| Paragraph 11.131 | Added to reflect the issuance of SAS No. 117. |
| Paragraph 11.135 | Revised to reflect the issuance of SAS No. 117. |
| Heading and paragraphs 11.136–.137 | Added to reflect information related to the Recovery Act. |
| Note to chapter 12 | Revised. |
| Former footnote * to heading before paragraph 12.01 | Deleted. |
| Paragraph 12.08 | Revised to reflect the issuance of SAS No. 117; footnote 2 added to reflect issuance of SAS No. 117. |
| Paragraph 12.09 | Revised for clarification. |
| Paragraph 12.16 | Revised to reflect the issuance of SAS No. 115 and SAS No. 117. |
| Paragraph 12.23 | Revised to reflect the issuance of SAS No. 117; footnote 3 added to reflect the issuance of SAS No. 117. |
| Paragraphs 12.24 and 12.30–.31 | Revised for clarification. |
| Paragraphs 12.33 and 12.36 | Revised to reflect the issuance of SAS No. 117 |
| Paragraph 12.37 | Revised to reflect the issuance of SAS No. 117, revised for clarification. |
| Paragraph 12.40 | Revised for clarification. |
| Heading and paragraph 12.48 | Added to reflect information related to the Recovery Act; footnotes * and † added. |
| Note to chapter 13 | Revised. |
| Former footnote * to heading before paragraph 13.01 | Deleted. |

| <u>Reference</u> | <u>Change</u> |
|-----------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Paragraph 13.06 | Revised to reflect wording in the revised OMB Circular A-133 reports, as revised for SAS No. 115 and SAS No. 117; footnote 2 revised to reflect the issuance of SAS No. 117; footnote 3 revised to reflect wording in the revised OMB Circular A-133 reports, as revised for SAS No. 115 and SAS No. 117. |
| Footnote 7 in paragraph 13.11 | Revised for the issuance of SAS No. 118, <i>Other Information in Documents Containing Audited Financial Statements</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 550), and SAS No. 119. |
| Note 4 in paragraph 13.16 | Revised to reflect wording in the revised OMB Circular A-133 reports, as revised for SAS No. 115 and SAS No. 117. |
| Paragraph 13.18 | Revised to reflect the issuance of SAS No. 117. |
| Paragraph 13.19 | Revised to reflect the issuance of SAS No. 117 and to reflect wording in the revised OMB Circular A-133 reports, as revised for SAS No. 115 and SAS No. 117. |
| Heading before paragraph 13.23 | Revised to reflect wording in the revised OMB Circular A-133 reports, as revised for SAS No. 115 and SAS No. 117; footnote * added; footnote 15 added for clarification. |
| Former footnote † to heading before paragraph 13.23 | Deleted. |
| Paragraph 13.23 | Revised to reflect the issuance of SAS No. 117 and to reflect wording in the revised OMB Circular A-133 reports, as revised for SAS No. 115 and SAS No. 117. |
| Former footnote ‡ in paragraph 13.23 | Deleted. |
| Paragraphs 13.26–.27 | Added to reflect the issuance of SAS No. 117. |
| Paragraph 13.31 | Revised to reflect wording in the revised OMB Circular A-133 reports, as revised for SAS No. 115 and SAS No. 117. |
| Paragraph 13.34 | Revised for the withdrawal of auditing interpretation; footnote 22 revised for OMB clarification regarding SAS No. 115. |
| Paragraph 13.38 | Revised to reflect wording in the revised OMB Circular A-133 reports, as revised for SAS No. 115 and SAS No. 117. |

(continued)

| <u>Reference</u> | <u>Change</u> |
|----------------------------------------------|----------------------------------------------------------------------------------------------------------------------|
| Footnote 30 in paragraph 13.48 | Revised for issuance of revised data collection form. |
| Paragraph 13.49 | Revised for passage of time; footnote † added. |
| Former paragraph 13.52 | Deleted due to issuance of SAS No. 115 and SAS No. 117. |
| Paragraph 13.52 | Revised for clarification. |
| Heading and paragraph 13.54 | Added to reflect information related to the Recovery Act; footnote ‡ added. |
| Footnote in paragraph 13.54 | Added. |
| Paragraph 13.55 | Added to reflect information related to the Recovery Act; footnote # added. |
| Paragraph 13.56 | Appendix A added, which contains illustrative reports based on the guidance in SAS No. 115; updated for SAS No. 117. |
| Note to chapter 14 | Revised. |
| Paragraph 14.01 | Revised to reflect the issuance of SAS No. 117; footnotes 1–2 added to reflect the issuance of SAS No. 117. |
| Paragraph 14.04 | Revised to reflect the issuance of SAS No. 117. |
| Paragraph 14.08 | Added to reflect the issuance of SAS No. 117. |
| Paragraph 14.10 | Revised to reflect wording in the revised OMB Circular A-133 reports, as revised for SAS No. 115 and SAS No. 117. |
| Footnote * in heading before paragraph 14.13 | Added. |
| Former paragraph 14.16 | Deleted due to issuance of SAS No. 115 and SAS No. 117. |
| Heading and paragraph 14.17 | Added to reflect information related to the Recovery Act; footnote † added. |
| Paragraph 14.18 | Appendix A added, which contains illustrative reports based on the guidance in SAS No. 115; updated for SAS No. 117. |
| Former Appendix B | Deleted due to reissuance on the OMB website of OMB Circular A-133, as revised on June 26, 2007. |
| Appendix B | Added due to reissuance on the OMB website of OMB Circular A-133, as revised on June 26, 2007. |

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